Docket: 2005-4472(IT)G

BETWEEN:

DEAN R. THORLAKSON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

and

CAROLYN THOMPSON,

Party as per s.174.

Appeal heard on September 10, 2007 at Kelowna, British Columbia

Before: The Honourable Justice Valerie A. Miller

Appearances:

Counsel for the Appellant:	Kenneth J. Ihas
Counsel for the Respondent:	John Gibb-Carsley
Counsel for the Carolyn Thompson:	Howard F. Peet

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* ("*Act*") for the 2003 taxation year is dismissed, with costs.

Signed at Ottawa, Canada this 27th day of September, 2007.

"V.A. Miller"

V.A. Miller, J.

Citation: 2007TCC576
Date: 20070927
Docket: 2005-4472(IT)G

BETWEEN:

DEAN R. THORLAKSON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

and

CAROLYN THOMPSON,

Party as per s.174.

REASONS FOR JUDGMENT

V. A. Miller, J.

[1] On February 2, 2007 this Court made an Order pursuant to section 174 of the *Income Tax Act* ("*Act*") to join Carolyn Thompson ("former spouse") as a party to the appeal of Dean Thorlakson. As a result, this decision answers the questions posed in the section 174 application and the issue in the appeal of Dean Thorlakson.

[2] The issue is whether for the 2003 taxation year the Appellant can claim a deduction of $30,800 as a spousal support payment in accordance with paragraph 60(b) of the *Act* and conversely the former spouse must include the amount of $30,800 in her income in accordance with paragraph 56(1)(*b*) of the *Act*.

[3] The Minister of National Revenue ("Minister") denied the $30,800 deduction claimed by the Appellant. The former spouse did not include the amount in her income. In making his assessment, the Minister relied on the facts set out in paragraph 11 of the Reply to the Notice of Appeal ("Reply") as follows:

11. In so reassessing the Appellant by Notices dated April 5, 2005 and September 29, 2005, the Minister relied on the same assumptions of fact as follows:

a) the facts stated and admitted above;

The Separation Agreement

b) the Appellant and Carolyn Thorlakson ("Carolyn") have been living separate and apart since September 1, 2000;

c) the Appellant and Carolyn entered into a separation agreement dated November 1, 2002 (the "Separation Agreement");

Spousal Support

d) under the Separation Agreement, the Appellant was required to pay spousal support to Carolyn totalling $30,800.00 for the 2003 taxation year, payable in four quarterly amounts on January 1st, April 1st, July 1st and October 1st;

e) the Separation Agreement did not require the Appellant to set up an annuity for the payment of spousal support to Carolyn;

f) the Appellant did not pay any spousal support amounts to Carolyn in 2003; and

g) the Appellant did not pay any amounts to Carolyn for her maintenance in 2003.

[4] The Appellant, self-employed; the former spouse, wealth consultant; and Mr. Jay Christensen, a financial planner, testified.

[5] The following facts are not disputed. The Appellant and his former spouse were married on October 19, 1996. They have lived separate and apart since September 1, 2000. They entered into a Separation Agreement ("Agreement") on November 1, 2002. They each had independent legal advice with respect to the Agreement and signed a Certificate to that effect.

[6] Paragraphs 27 to 30 of the Agreement provided for spousal support as follows:

SPOUSAL SUPPORT

27. The parties agree that Dean will pay Carolyn spousal support from January 1, 2002 to December 31, 2005 at the amount of $30,800.00 per year, payable periodically commencing January 1, 2002, payable January 1st, April 1st, July 1st and October 1, to and including October 1, 2005. Commencing January 1, 2006, and up to and including December 31, 2007, Dean agrees to pay to Carolyn spousal support calculated at $18,000.00 per year; again, payable quarterly commencing January 1, 2006 and payable January 1st, April 1st, July 1st and October 1st. Commencing January 1, 2008, and up to and including December 31, 2008, Dean agrees to pay to Carolyn spousal support calculated at $15,000.00 per year; again, payable quarterly commencing January 1, 2008 and payable January 1st, April 1st, July 1st and October 1st with the last payment to be made October 1, 2008, at which time Dean's obligation to pay spousal support will have been fully satisfied.

28. The parties agree that the aforesaid periodical maintenance payments will be taxable in Carolyn's hands and deductible in Dean's hands.

29. The parties agree that the aforesaid payments represent a full and final settlement of any inequity in the division of family assets between the parties, and sufficiently compensates Carolyn for any economic disadvantage suffered as a result of the marriage, and provide her with a complete and adequate opportunity to become self-sufficient.

30. The parties agree that, except as set out in this agreement, neither of them will make any claim now or at any time in the future for spousal support, and this agreement, and all of its terms may be referred to in defence of any such application that might be made at any time in the future.

[7] The testimony of the witnesses disclosed that while negotiating the Agreement the former spouse expressed concern that the Appellant would not make the spousal support payments on a timely basis. She was also concerned about being financially dependent on the Appellant and/or his family. In 2002, the former spouse was working part-time at the Bank of Montreal, taking care of her children and studying to receive her Bachelor of Business Administration. Her annual salary was approximately $19,000. She proposed that she receive an income supplement so that her average annual income equal approximately $50,000 for the next 8 years. She asked that the spousal support be a lump sum payment. The Appellant rejected this as he wanted to receive the deduction for periodic payments.

[8] To allay the former spouse's concerns and to satisfy the Appellant, it was agreed that the support payments would be paid by way of an annuity which was to be funded by the Appellant. The former spouse met with Jay Christensen to discuss the annuity and it was decided that the annuity would be purchased from Manulife Financial. On November 25, 2002, the former spouse applied for two annuities with Manulife Financial. The Appellant paid for the purchase of the policies by way of cheque dated November 29, 2002 made out to Manulife Financial in the amount of $136,678.99 and drawn on the account of Timber Investments Ltd..

[9] The documentary evidence showed that the former spouse applied for two term certain annuities; she was the annuitant, the owner and the payee on the policies. She named her sons as beneficiaries under the policies and the Appellant as trustee for the beneficiaries. The policy, which is relevant for the 2003 taxation year, guaranteed annuity payments for three years and six months to be paid quarterly in the amount of $7,700 per quarter with payments to start on January 1, 2003 and to end on October 1, 2005. Payments were made in accordance with the policy by direct deposit to the former spouse's bank account. As well, the former spouse received a T4A for the 2003 taxation year from Manufacturers Life Insurance Company for interest income of $794.52 earned by the annuity.

[10] The Appellant testified that he had no discussions with the financial advisor who set up the annuity nor did he see any documentation with respect to the annuity until this proceeding.

[11] The relevant provisions of the *Act* are paragraphs 56(1)*(b)*, 56.1(4) and 60(b) which read as follows:

> 56. (1) Without restricting the generality of section 3, there shall be included in computing the income of a taxpayer for a taxation year, …
>
> Support
>
> (*b*) the total of all amounts each of which is an amount determined by the formula
>
> A - (B + C)
>
> where
>
> A is the total of all amounts each of which is a support amount received after 1996 and before the end of the year by the taxpayer from a particular person

where the taxpayer and the particular person were living separate and apart at the time the amount was received,

B is the total of all amounts each of which is a child support amount that became receivable by the taxpayer from the particular person under an agreement or order on or after its commencement day and before the end of the year in respect of a period that began on or after its commencement day, and

C is the total of all amounts each of which is a support amount received after 1996 by the taxpayer from the particular person and included in the taxpayer's income for a preceding taxation year;

Support

56.1 (4) The definitions in this subsection apply in this section and section 56. …

"support amount"
«*pension alimentaire* »

"support amount" means an amount payable or receivable as an allowance on a periodic basis for the maintenance of the recipient, children of the recipient or both the recipient and children of the recipient, if the recipient has discretion as to the use of the amount, and

(*a*) the recipient is the spouse or common-law partner or former spouse or common-law partner of the payer, the recipient and payer are living separate and apart because of the breakdown of their marriage or common-law partnership and the amount is receivable under an order of a competent tribunal or under a written agreement; or

(*b*) the payer is a legal parent of a child of the recipient and the amount is receivable under an order made by a competent tribunal in accordance with the laws of a province.

60. There may be deducted in computing a taxpayer's income for a taxation year such of the following amounts as are applicable …

Support

(*b*) the total of all amounts each of which is an amount determined by the formula

A - (B + C)

where

A is the total of all amounts each of which is a support amount paid after 1996 and before the end of the year by the taxpayer to a particular person, where the taxpayer and the particular person were living separate and apart at the time the amount was paid,

B is the total of all amounts each of which is a child support amount that became payable by the taxpayer to the particular person under an agreement or order on or after its commencement day and before the end of the year in respect of a period that began on or after its commencement day, and

C is the total of all amounts each of which is a support amount paid by the taxpayer to the particular person after 1996 and deductible in computing the taxpayer's income for a preceding taxation year;

SUBMISSIONS

[12] It is the Appellant's position that the Court should look at only the Agreement to determine if the amounts paid to the former spouse were support amounts within the definition at subsection 56.1(4) of the *Act*. He says that the annuity was just the vehicle used to pay the support.

[13] He relied on the decision in *McKimmon v. Canada (Minister of National Revenue – M.N.R.)*, [1990] 1 F.C. 600 to argue that the character of the obligation as stated in paragraph 27 of the Agreement is periodic support. He stated that the terms of the Agreement show the intent of the parties when executing the Agreement. Finally, he relied on *Ostrowski v. Canada*, [2002] F.C.J. No. 1123 and *Pouzar v. Canada*, [2007] T.C.J. No. 205 for the proposition that the Court must consider the foundation of the payment obligation (the Agreement) separate and apart from the terms and conditions of the actual payment (the annuity).

[14] In conclusion, counsel for the Appellant argued that the amount of $30,800 was receivable under a written agreement and the fact that payments are made or received through a third party does not make the payments non-deductible where the spouses consent. (*Arsenault v. Canada*, [1995] T.C.J. No. 241 (T.C.C.)).

[15] It is the Respondent's position that the payment the court must analyze is the payment made by the Appellant to Manulife Financial. He stated that the payment was a lump sum payment and not a support amount. As well, he submitted that the payment to purchase the annuity was the transfer of capital into an income stream.

In conclusion, the Respondent relied on the reasons of Linden J.A. of the Federal Court of Appeal in *Friedberg v. Her Majesty the Queen*, 92 D.T.C. 6031 (affirmed by the Supreme Court of Canada, [1993] 4 S.C.R. 285), at p.6032, where he said:

> In tax law, form matters. A mere subjective intention, here as elsewhere in the tax field, is not by itself sufficient to alter the characterization of a transaction for tax purposes. If a taxpayer arranges his affairs in certain formal ways, enormous tax advantages can be obtained, even though the main reason for these arrangements may be to save tax (see *Canada v. Irving Oil Ltd.*, [1991] 1 C.T.C. 350, 91 D.T.C. 5106, per Mahoney, J.A.). If a taxpayer fails to take the correct formal steps, however, tax may have to be paid. If this were not so, Revenue Canada and the courts would be engaged in endless exercises to determine the true intentions behind certain transactions. Taxpayers and the Crown would seek to restructure dealings after the fact so as to take advantage of the tax law or to make taxpayers pay tax that they might otherwise not have to pay. While evidence of intention may be used by the courts on occasion to clarify dealings, it is rarely determinative. In sum, evidence of subjective intention cannot be used to "correct" documents which clearly point in a particular direction.

On the basis of the above, counsel for the Respondent contended that it is not what the Appellant intended to do but what he actually did that is relevant to the characterization of the payment.

ANALYSIS

[16] I do not agree with the Appellant's position. The Agreement may stipulate that the Appellant would pay the former spouse periodic payments; however, the documentary and oral evidence disclose that the Appellant made a lump sum payment of $136,678.99 in 2002 to enable his former spouse to obtain two annuities. The Court cannot ignore the actual transactions that occurred and look only at the parties intentions as evidenced by the Agreement. In fact the former spouse testified that she always wanted the support payment to be in the form of a lump sum so that she would not have to include it in income. The Appellant has to be taxed on how he arranged his affairs, not how he could have arranged his affairs.

[17] The Appellant was represented by counsel when he negotiated and signed the Agreement and when he agreed to fund the purchase of the annuities for his former spouse. He was also represented by counsel when it was decided how he would fund the purchase of the annuities. His liability for income tax does not depend on the Agreement between him and his former spouse but on the application of the relevant sections of the *Act. (Ouellet v. The Queen* (2000), 55 D.T.C. 3688)

[18] In his submissions counsel for the Appellant relied on the decisions in *Ostrowski* and *Pouzar* to support his position. In both cases the foundation of the support obligation was a court order for periodic payments. In *Ostrowski* the court ordered that the payments be made in advance while the cash was on hand and in *Pouzar* the court ordered that the husband purchase an annuity to secure the periodic payments. In the present appeal the Agreement does not contain any reference to the annuity. I do not opine that if the Agreement did reference the annuity the payments would be deductible, I state this only to distinguish those cases from this appeal.

[19] In his submissions, counsel for the Appellant referred to only two sections of the *Act* - the definition of support amount in subsection 56.1(4) and paragraph 56(1)(*b*) for the amount to be included in income. These sections of the *Act* cannot be analyzed in isolation. There is a correlation between paragraphs 56(1)(*b*) and 60(b) and in the circumstances of this appeal paragraph 60(b) is very relevant.

[20] The Appellant is only able to deduct an amount under paragraph 60(b) if the payment was periodic in nature and made pursuant to a court order or a written agreement. The amount of $136,678.99 paid by the Appellant in 2002 was not a support amount. It was not an amount that was payable on a periodic basis. Consequently the amount is not deductible pursuant to paragraph 60(b) and the former spouse does not have to include the amount of $30,800 in her income for the 2003 taxation year.

[21] Reluctantly I must dismiss the appeal. I say reluctantly because the parties did agree that the payments would be deductible by the Appellant and taxable by the former spouse. However, the agreement to provide an annuity to the former spouse constituted a fundamental modification, not only in the form of the transaction but also in its substance.

[22] The appeal is dismissed with costs.

Signed at Ottawa, Canada this 27th day of September, 2007.

"V.A. Miller"

V.A. Miller, J.

CITATION:	2007TCC576
COURT FILE NO.:	2005-4472(IT)G
STYLE OF CAUSE:	Dean R. Thorlakson v. HMQ and Carolyn Thompson
PLACE OF HEARING:	Kelowna, British Columbia
DATE OF HEARING:	September 10, 2007
REASONS FOR JUDGMENT BY:	The Honourable Justice Valerie Miller
DATE OF JUDGMENT:	September 27, 2007

APPEARANCES:

Counsel for the Appellant:	Kenneth J. Ihas
Counsel for the Respondent:	John Gibb-Carsley
Counsel for Carolyn Thompson:	Howard F. Peet

COUNSEL OF RECORD:

For the Appellant:

Name:	Kenneth J. Ihas
Firm:	Petraroia Langford Rush LLP

For the Respondent:	John H. Sims, Q.C. Deputy Attorney General of Canada Ottawa, Canada