



## WHEN PRIVATE BUSINESS OWNERS GET DIVORCED

*A heads-up from an independent business valuator's perspective*

### EXECUTIVE SUMMARY

Private business owners may be surprised to learn that the income a court uses for child and spousal support is not necessarily the same as the income shown on their personal and corporate tax returns. The Canada Revenue Agency (CRA) focuses on taxable income under the Income Tax Act (ITA). Ontario family courts, instead, apply the Federal Child Support Guidelines<sup>1</sup> (FCSG) that can look through the *corporate veil*<sup>2</sup> to assess the resources actually available to a payor beyond amounts reported on T2 tax filings. In practice, this means a Chartered Business Valuator (CBV) engaged to produce an Expert Report prepared under the CBV Institute's practice standards no. 310, may add back non-business, or discretionary expenses, charged to a business and apply a "gross-up" to convert after-tax benefits into a pre-tax income equivalent. This article provides a brief outline of what private business owners may see in the context of divorce.

### INCOME TAX ACT ≠ FEDERAL CHILD SUPPORT GUIDELINES

The ITA is designed to measure taxable income and encourage legitimate business activity. It allows deductions that are reasonable to earn income and, in certain cases, permits income-splitting, deferrals, and preferences (e.g., capital cost allowance, shareholder loans).

The FCSG, by contrast, seeks to measure a parent's ability to pay support. It looks through corporate structures and asks: what economic resources does the payor control or enjoy? If the company pays for personal items or provides in-kind benefits, those amounts may be treated as income to the shareholder, per section 19(1) of the FCSG.

The important point to note about considerations under section 19(1) is that an independent business valuator may apply adjustments to income even if the corporate expenses are permitted by the CRA, per section 19(2) of the FCSG. In other words, business owners can expect there to be a difference between how their company's pre-tax income is determined by their accountant under the ITA and applicable accounting standards, compared to a CBV analyzing a business in the context of the FCSG. Let's take a look at some categories where difference may arise.

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<sup>1</sup> <https://laws-lois.justice.gc.ca/eng/regulations/sor-97-175/page-2.html#h-1004287>

<sup>2</sup> In *Lynch v. Segal*, 2006 CanLII 42240 (ON CA), MacPherson J.A. said, at paras. 48-49: "*In the end, although a business person is entitled to create corporate structures and relationships for valid business, tax and other reasons, the law must be vigilant to ensure that permissible corporate arrangements do not work an injustice in the realm of family law. In appropriate cases, piercing the corporate veil of one spouse's business enterprises may be an essential mechanism for ensuring that the other spouse and children of the marriage receive the financial support to which, by law, they are entitled.*"





## COMMON ITEMS CONSIDERED UNDER THE FCSG

While considerations are case specific, the general theme is that if an expense primarily benefits the owner personally, it is likely to be treated as non-business (or partly non-business) and added to income.

- **Owner benefits paid by the business:** personal vehicle costs, fuel, insurance, parking, club/fitness memberships, home internet and cell phone plans beyond business needs, personal travel blended into a business trip.
- **Meals and entertainment:** tax rules already limit deductibility (often 50%), but for support the personal component may be added back entirely if deemed to primarily benefits the owner.
- **Family members on payroll:** salaries to a spouse or child must reflect actual work and market rates. Excess or non-commercial compensation is commonly added back.
- **Shareholder loans and draws:** repayments of shareholder loans that originally funded personal spending, or recurring cash draws booked to the shareholder, are scrutinized as disguised remuneration.
- **Home-office claims:** CRA allows reasonable allocations; a CBV may apply a strict business-use percentage and add back the personal portion.
- **Insurance and medical benefits:** corporate-paid life insurance (non-deductible for tax except specific cases) and executive health plans may be treated as personal benefits and included as income.
- **Discretionary professional fees:** legal/accounting fees tied to the owner personally (estate planning, family law, tax planning for wealth extraction) are generally added back.
- **One-time or non-recurring items:** for tax, they may be deductible; for support, a CBV may normalize by removing unusual losses and adding back unusual owner-specific perks.

## A SIMPLE ILLUSTRATION OF HOW NON-BUSINESS EXPENSES ARE TREATED

Assume a shareholder-manager reports \$100,000 of taxable income and a CBV notes \$24,000 of corporate-paid personal vehicle and cell phone costs, \$6,000 of club dues, and \$10,000 of family payroll above market rates. This \$40,000 in non-business and/or excessive items are added back as after-tax benefits. Assuming a 40% marginal tax rate, the pre-tax equivalent on this would be:  $\$40,000 \div (1 - 0.40) = \$66,667$ . Preliminary Guideline income, all else being equal, then becomes  $\$100,000 + \$66,667 \approx \$166,667$ . This example is not exhaustive as additional adjustments (e.g., retained earnings access, capital gains, or income-splitting reversal) may also be appropriate.

## CLOSING THOUGHTS

An expense can be perfectly acceptable for tax purposes and still be treated as income for child support purposes. Ontario courts, and CBVs applying the FCSG, look through corporate deductions to the owner's real spending power. Depending on the degree to which personal expenses have been charged through your business, if any, you may see adjustments to your income that extend beyond amounts reported on your T1





and T2 tax filings. Keep in mind that while the CRA may ask, “was the expense reasonable to earn income?”, a CBV guided by the FCSG may ask, “does the expense confer a personal benefit to the business owner and should it be included (along with a gross-up) in Guideline income?”

Thank you,

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#### REFERENCES

1. Income Tax Act (Canada) - <https://laws-lois.justice.gc.ca/eng/acts/l-3.3/>
2. Federal Child Support Guidelines - <https://laws-lois.justice.gc.ca/eng/regulations/sor-97-175/index.html>
3. CBV Institute – practice standard no. 310 - <https://cbvinstitute.com/wp-content/uploads/2020/02/Practice-Standard-No.-310-E-2009.pdf>

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