

SHAREHOLDER BENEFITS:

Certain Legal and Accounting Fees

Background

Section 15 of the Income Tax Act provides that shareholder benefits received from a corporation must be included in the shareholder's personal income when incurred for the personal benefit of a shareholder who is an individual. The shareholder benefit rules are designed to prevent corporations from funding shareholder's personal expenses out of pre-tax corporate funds. Corresponding to the inclusion of a benefit in the shareholder's personal income is a denial of the deduction to the corporation.

The possibility of a shareholder benefit becomes a consideration for the owner/manager who may incur significant accounting legal and valuation expenses in connection with estate planning of his or her interests in an operating business. For example, in a typical estate freeze, the owner/manager exchanges his common shares of the business for preferred shares, and the business entity then issues new common shares to a family trust. The future growth in value of the business will accrue to the trust for the benefit of the owner/manager and his or her family as beneficiaries of the trust.

Planning of this nature usually involves some significant accounting, legal and valuation expenses. Are these expenses deductible by the corporation, or are they personal to the shareholder(s) which, if paid by the corporation, represent a taxable shareholder benefit? This question came directly before the Tax Court in *Truck Base Corporation v. The Queen* in 2006.

Fees for Corporate Re-organizations and Estate Planning

It was conceded before the Court that legal fees of \$1500 paid to create the family trusts were personal and represented shareholder benefits. However, the corporation argued that the corporate reorganization, including the redesign and amendment of the corporation's share capital and the estate freezes, were necessary business expenses of the corporation rather than expenses incurred for the personal benefit of the owner/manager.

The Tax Court agreed with the taxpayer that these re-organization costs were properly deductible by the corporation as legitimate business expenses.

Fees for Shareholders' Agreements

In the case, there were 2 active shareholders, both of which completed estate freezes at the same time. As part of this process, they also incurred substantial expenses to update and re-draft their shareholders' agreement. The Tax Court also held that the shareholders' agreement was very significant to protect the corporation in its relationship with the shareholders and determined that the fees incurred to re-draft the shareholders' agreement were not personal expenses of the shareholders. Interestingly, because the shareholders' agreement was being re-written and re-drafted, the Tax Court also permitted the corporation to deduct the whole cost of the legal fees as current expenses, as opposed to capital outlays, and likened the re-drafting of the shareholders' agreement to the maintenance and repair of a business asset.

While each instance will depend on its own facts, this decision in the Tax Court in *Truck Base Corporation v. the Queen* is authority for the proposition that the corporation has its own legitimate interest, and expenses incurred by it relating to those interests should be deductible by the corporation even when the shareholders have a strong personal interest in completing the estate freeze or drafting a shareholders' agreement, as in this case. However when expenses genuinely only benefit the owner/manager and shareholder (in this case, expenses associated with creating the family trust), the legal and accounting fees will be a shareholder benefit if they are paid by the corporation.

Fees Incurred on a Sale of Shares

Although it is not addressed in this case, legal and accounting expenses incurred during the course of a sale of shares by the owner/manager will also be taxable benefits if paid by the corporation, but often transactions that involve the sale of shares will also involve some significant work on corporate matters as part of the transaction. If there is a fair allocation of those fees between the corporation and the shareholder(s), the amounts fairly allocated to the corporation should be deductible by it without the imposition of taxable benefits to the shareholders.

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