F I E L D L A W

Dealing With Your Corporation

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Shareholders of corporations need to be cautious when dealing with the corporation in which they own shares. Although the shareholders of a corporation control the corporation and have significant flexibility under corporate law provisions, any dealings with the corporation may have tax implications. Even if you own all of the shares of your corporation, the corporation is a distinct legal entity from you and any movement of assets, which includes cash, from your corporation to you or vice versa may attract a tax liability. Be prepared for this liability or alternatively seek measures to avoid it by consulting with your tax lawyer.

Transfer of Assets to the Corporation

The Income Tax Act provides that any transaction with a non-arm's length party must take place at fair market value. If you own assets and transfer the assets to a corporation, even if you own all of the shares of the corporation, there is a deemed disposition of the assets at fair market value unless a special election is made between you, as the owner of the assets, and the corporation. If the requirements of the tax-free rollover are met and the election is properly completed and filed with Revenue Canada, there will be no tax consequences as a result of the transfer of assets from you to your corporation. If the election is not properly completed or filed, you may be required to include in your income in the year of transfer the difference between the fair market value of the assets transferred and the cost of the assets to you. Without the election, this income inclusion is not affected by the amount of cash paid by the corporation to you, the shareholder. The income inclusion takes place even if the corporation does not pay the shareholder any cash.

It is always best to seek professional advice when transferring assets to a corporation, whether or not it is wholly owned. Indeed, where there are other shareholders, matters become even more complicated, particularly if the other shareholders of the corporation are family members.

Transfer of Assets from the Corporation

You must also be cautious when removing assets from a corporation, even though it might seem that you should be able to do what you wish with the assets, particularly if you own all of the shares of the corporation. If the corporation owns certain assets which you wish to own directly or to use personally there may be tax consequences when the assets are taken out of the corporation or used by you. When assets owned by the corporation are transferred to a shareholder, there is a deemed disposition of the assets at fair market value. This would trigger tax in the corporation if the asset had increased in value during the period when the corporation owned the asset. In addition, the shareholder would have an inclusion in income as a deemed dividend equal to the fair market value of the asset received. If the shareholder personally uses assets of the corporation, there can be a taxable benefit to the shareholder equal to the fair market value of the assets used by the shareholder.

Loans from the Corporation

If you borrow money from a corporation in which you own shares, this can also

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trigger tax consequences to you except in very limited circumstances. Generally, a shareholder is not allowed to remove money from a corporation without any tax consequences. If a shareholder uses funds belonging to the corporation for personal expenses, it would be an immediate inclusion in income and the shareholder would be required to pay tax on the amount at the applicable marginal rate unless the transaction is treated as a loan from the corporation to the shareholder. Caution is required if the transaction is treated as a loan. Since the exceptions to the inclusion in income in this situation are very limited, a tax advisor should be consulted prior to any removal of funds from the corporation to avoid paying tax on those funds.

Paying Salaries to Family Members

There are provisions in the Income Tax Act that allow Revenue Canada to review payments to family members. If the payments are not reasonable, the corporation will not be allowed to deduct the payments and the family members will still have to pay tax on the funds received.

Corporations are separate legal entities from the individual shareholders and the existence of the corporation as such cannot and must not be ignored. If you ignore the corporation, you do so at your own peril.

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