



Shareholder and indirect benefits

In a recent technical interpretation (#2015-0575911E5), the CRA confirmed that shareholder and indirect benefits will arise when property is transferred from a corporation to a shareholder's spouse for less than fair market value (FMV) consideration. Our unofficial translation of the situation and questions raised is as follows:

Corporation A has four individual shareholders (shareholders 1, 2, 3 and 4) who hold shares of the capital stock of Corporation A, in equal shares. The four shareholders are not related. Corporation A reportedly disposed of capital property in favour of the spouse of shareholder 4. The spouse of shareholder 4 is dealing at arm's length with shareholders 1, 2 and 3. It was determined that the price of the transaction with the spouse of shareholder 4 was less than the FMV of the asset disposed of and, consequently, results in a benefit. The spouse of shareholder 4 is neither a shareholder (nor is in the process of becoming one) nor an employee of Corporation A (or of Holdco for question b).

- a. what are the tax consequences of this transaction?
- b. (will) the answer be the same if the four shareholders were shareholders instead, in the same proportions, of a corporation (Holdco) that holds all the shares of the capital stock of Corporation A?
- c. if the answer to question a) would be the same if the four shareholders were brothers?

The CRA responded in question a) that shareholder 4 would include the value of the benefit conferred (the difference between FMV and the purchase price) under subsection 15(1) and (1.4) as a shareholder benefit because the spouse is not at arm's length and is affiliated with shareholder 4.

The response to question b) was that either Holdco would include the value of the benefit in its income under subsection 15(1) and (1.4), because the spouse of the shareholder of Holdco would not be dealing at arm's length with Holdco or would be affiliated with Holdco. Alternatively, subsection 56(2) would be invoked to include the benefit in Holdco's income since the transfer would have been made by Corporation A to the spouse of the Holdco shareholder with Holdco's "instructions" and "consent", and the payment or transfer would have otherwise been a shareholder benefit to Holdco under 15(1).

The CRA stated that it is impossible to determine if all the facts and circumstances required for the application of 56(2) exist and concluded that "it appears possible to us that the difference between the FMV of the transferred property and the consideration received by Corporation A could be included in computing the income of shareholder 4 of Holdco.", or, if shareholder 4 is an employee of Corporation A (which he would be deemed to be if he were a director of Corporation A), it could be included as an employee benefit under 6(1)(a).

And, for good measure, the CRA stated that subsection 246(1)(a) could apply to include the amount of the benefit in the income of shareholder 4.

In response to question c) even though the spouse of shareholder 4 would also not be dealing at arm's length with her brothers-in-law, because the benefit would be included in shareholder 4's income, it would not be also included in the incomes of shareholders 1, 2 and 3.

This response can be easily analogized to a transfer of a life insurance policy to a shareholder's spouse for inadequate consideration. Just because there may be no T5 issued on the transfer of the policy, it does not mean there are no tax consequences on the transaction. To the extent that the FMV exceeds the purchase price, there will be a taxable benefit to someone!

September 2015

FOR ADVISOR USE ONLY

The Tax, Retirement & Estate Planning Services at Manulife writes various publications on an ongoing basis. This team of accountants, lawyers and insurance professionals provides specialized information about legal issues, accounting and life insurance and their link to complex tax and estate planning solutions. These publications are distributed on the understanding that Manulife is not engaged in rendering legal, accounting or other professional advice. If legal or other expert assistance is required, the service of a competent professional should be sought. These columns are current as of the time of writing, but are not updated for subsequent changes in legislation unless specifically noted. This information is for Advisor use only. It is not intended for clients. This document is protected by copyright. Reproduction is prohibited without Manulife's written permission. Manulife, the Block Design, the Four Cube Design, and Strong Reliable Trustworthy Forward-thinking are trademarks of The Manufacturers Life Insurance Company and are used by it, and by its affiliates under licence.

Previous columns