

Personal use assets owned by a corporation

Kim G C Moody FCPA, FCA, TEP
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As mentioned in our blog of [September 29, 2009](#), one of the most common errors that we identify during our review of private corporations is the corporate ownership of personal use assets. The shareholders of the corporation will often believe that it is tax efficient to purchase assets inside the corporation that would otherwise involve the withdrawal of funds from the corporation to purchase such assets (which would be a taxable withdrawal). Unfortunately, the tax consequence of the acquisition of personal use property by a corporation is not pretty. We often see vacation homes, automobiles, boats, art collections, etc. owned by the corporation. Certainly the most common examples we see are vacation property and in some unusual cases the primary residence of the shareholder(s).

There has been no shortage of tax jurisprudence involving this type of issue. The biggest tax consequence is that the shareholder(s) will usually have been considered to have received a taxable benefit from the corporation. In other words, the corporation conferred a benefit on the shareholders. The obvious question becomes how to calculate the quantum of the benefit.

In *Mullen v. The Minister of National Revenue* 90 DTC 1551, certain individual shareholders of a holding company, which in turn owned shares of a subsidiary company, were reassessed by the Minister of National Revenue for a shareholder benefit for the use of a California condominium that the subsidiary company owned and the individuals rarely used. For the days that the individuals actually used the condo, they had included \$100 each/day in their income. The Minister reassessed the individuals for the vacant days as well. However, upon appeal, the individuals were found to have not received a benefit during the vacant days. In practice, this was often found to be an acceptable way to compute the taxable benefit.....a reasonable rent or hotel rate that would be charged to arm's length parties.

However, in cases since *Mullen* and in particular two significant cases – *Youngman v. The Queen* 90 DTC (FCA) and [Fingold v. The Queen](#) 97 DTC 5449 (FCA) – the Court found that fair market value rental was not the correct method to determine the quantum of the shareholder benefit. Instead, the Court determined in both cases that an equity rate of return on the personal use assets was the correct standard to determine the benefit. In other words, what price would the shareholder have had to pay, in similar circumstances, to get the same benefit from a company of which he was not a shareholder. This, of course, will be always a question of fact, but following the legal principles as set out above, can lead to some staggering shareholder benefit inclusions which far exceed fair market value rentals. A recent case – [Arpeg Holdings Ltd. v. The Queen](#) (FCA) 2008 DTC 6087, recently challenged the appropriateness of the cost of capital approach to computing the shareholder benefit. However, the Federal Court of Appeal dismissed such a challenge. The Canada Revenue Agency confirms that it calculates the quantum of the benefit using the rate of return method as stated in [Interpretation Bulletin IT-432R2 \(see paragraph 11\)](#).

In addition to the taxable benefits, when dealing with personal use real estate property, additional tax consequences can result given that the fact that the principal residence exemption will not be available upon an ultimate disposition of the property by the corporation. (As a gentle reminder, the principal

residence exemption can be utilized by individual Canadian residents to the extent that they habitually use the property as their personal residence and the property is not a rental property). Any surplus removed from the corporation will likely result in certain taxation amounts as well.

Accordingly, personal use property owned by a corporation can be a tremendous headache with very little planning available to offset the negative consequences. Our usual recommendation is to always remove personal use property from a corporation so as to relieve oneself from the significant taxable benefits and headaches that surround this matter.

Caution!