



## Legal expenses of a corporation

Many corporations incur legal fees throughout their taxation year. But are these expenses deductible to the taxpayer? The answer is quite simply, it depends. The Income Tax Act (Canada) provides for a general deduction of legal fees if the expenses were incurred for the purposes of gaining or producing business or property income, as long as the expenses were not capital in nature. For corporations, this general provision provides a deduction for legal fees with respect to normal business functions such as the preparation of business contracts, preparation of minutes of shareholders' and directors' meetings, and the costs associated to defend or prosecute most tort, contract or other civil claims arising in the ordinary course of business. In addition, under a special provision of the Act, the legal expenses associated with the preparation and filing of an objection or appeal with respect to an assessment of domestic or foreign income, excise or property tax, and any related interest or penalties are also deductible in the year incurred.

Legal fees that are capital in nature are not permitted as a deductible expense under the Act. However, these types of expenses are generally afforded other tax treatment. For example, legal costs incurred on the acquisition of capital property are added to the cost base of the property and costs incurred on the disposal of capital property are treated as outlays, reducing the capital gain or potentially increasing any capital loss. Fees paid to lawyers in connection with incorporations, amalgamations and corporation reorganizations are also considered capital in nature. Three quarters of the aggregate amount of these expenses are added to a notional account and a special deduction is permitted by the corporation at 7% per annum.

Lawyers may also be involved when arranging, issuing or restructuring financing. Any legal costs associated with the issuance of bonds, mortgages, debentures, borrowing money for business or property purposes, or restructuring a debt obligation are deductible, but only to a maximum of 1/5<sup>th</sup> per year for 5 years.

In summary, legal expenses are deductible in a corporation if they were incurred in connection with generating business or property income. If the expenses are capital in nature, there are specific tax provisions that allow them to be deducted, but usually only over a period of time. Some legal expenses may appear to be related to the day-to-day operations of the business, but in fact relate to the capital of the corporation. It is therefore wise to consult with your tax accountant in determining the appropriate tax treatment.