Shareholder Loans – Re-run
The dog gets his shoe-toy and the taxman gets a bite of his own.

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I had to digest my share of sadness when my sister went off to elementary school and left me as the only young child at home. Part of that grief was relieved by the companionship of our two very mischievous dogs, Laman and Lemuel. Never on a leash, the two Labrador Retrievers intimidated anyone who came by, not because they were particularly vicious, but because they both had a foot fetish.

Walking past the Ryan house was probably difficult even without the dogs. The neighborhood kids were convinced that my brother was a werewolf. Every time a friend came over he growled and chased them away with deer antlers, leg-hold traps, or whatever tool was nearby. Like my brother, our dogs loved to intimidate, even if they were as harmless as the resident bogeyman.

Around 3 o'clock every weekday afternoon, I would pull up a small chair in our carport with my two faithful companions and wait for the high school kids to walk by. Mom was at work, and I was in the care of my recently-graduated sister, who was probably painting her toenails, peeling a boiled egg, or listening to the Beatles – or all three.

When the surge of school kids hit the street, invariably one of the dogs would get out of my control and sprint after a nervous student, not drawing blood, but deftly gnawing a shoe off their foot. Most shoes in those days were made of leather, and our dogs had a collection of variously-sized chewed shoes in our carport, which nobody dared come and ask for (see above – werewolf). It was my job to make sure they didn't add to the collection, but I was only five years old. The dogs were like horses to me!

And honestly, the entertainment value was outstanding! The dog would parade around, head high, stinky leather shoe a great prize in his mouth. The wide-eyed school kid, uncertain if it was actually a dog, or my brother, would turn away whimpering, and limp-run home. No shoe was ever claimed, but I distinctly recall us discussing how we might arrange to obtain the matches for some of the nicer ones.

Eventually the young people just learned to go a different route home and my afternoon ritual faded.

Try this idea on:
In our ongoing series about how to take a bite out of, and eventually spend, the hard-earned cash accumulated in your corporation, we now look at the consideration of borrowing it from the company you control, and the ramifications of that idea.

Shareholder Loans
You might ask: “If I need to access money from my corporation, why not simply borrow it?”

The Income Tax Act contains very specific rules limiting the ability of a shareholder to borrow funds from their corporation. The general rule is if you borrow funds from your corporation and the loan is not repaid within one year after the end of your corporation’s fiscal year-end in which the loan was made, then the amount borrowed is included in your personal income in the year you borrowed the money.

For example, if your corporation’s year-end is December 31 and you borrowed money on November 1 of year 1, you would have to be repay that loan by December 31 of year 2, to avoid the income inclusion in your personal income for year 1.

In situations where you are subject to the income inclusion, you can later get a deduction on your personal tax return in the year you repay the loan. It is not possible to avoid these rules if you borrow funds, repay it within the time frame allowed, but then immediately re-borrow the funds.

There are four exceptions to the income inclusion rules (there are others but they are outside the scope of this article). These exceptions apply only if the loan is made to you in your capacity as an employee and not as a shareholder. In addition, at the time the loan is made, verifiable arrangements must be made to repay the loan within a reasonable time.

The first exception to the income inclusion rules is a loan made to an employee/shareholder that owns less than 10% of the shares of the corporation. The other three exceptions apply to loans for very specific purposes: the purchase of a home, the purchase of a car for use in carrying out the duties of employment, the purchase of treasury shares of the corporation. To reiterate, for all these four exceptions to apply, the loan must have been made to the shareholder in their capacity as an employee and not because of their shareholdings.

If you meet the exceptions or the loan is repaid in time so that there is no income inclusion, you may still have a deemed interest benefit that is taxable to you if the loan is a no- or low-interest bearing loan.

This article should not be viewed as individualized tax or legal advice. The shareholder loan rules are complex. Speak with a qualified tax advisor if you wish to borrow from your corporation.

Mark Ryan is an Investment Advisor with RBC Dominion Securities Inc. (Member–CIPF), and these are Mark’s views, and not those of RBC Dominion Securities. This article is for information purposes only. Please consult with a professional advisor before taking any action based on information in this article. Mark can be reached at mark.ryan@rbc.com.