



NO.: **IT-432R2**

DATE: February 10, 1995

SUBJECT: INCOME TAX ACT  
**Benefits Conferred on Shareholders**

REFERENCE: Subsection 15(1) (also sections 84 and 246; subsections 15(1.1) to 15(1.4), 15(7), 52(1), 52(1.1), 56(2) and 248(1) definitions of “property”, “corporation”, “shareholder” and “specified shareholder”; paragraphs 6(1)(a), 69(1)(b), 82(1)(a) and 214(3)(a); and subparagraph 129(1)(a)(i) of the *Income Tax Act*; and subsections 20(1) and 26(5) of the *Income Tax Application Rules, 1971* (ITAR))

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## **Application**

This bulletin cancels and replaces IT-432R dated June 19, 1985.

## **Summary**

This bulletin discusses the taxation of shareholder benefits. Subject to specific exceptions, the amount or value of any benefit conferred by a corporation on a shareholder is included in the shareholder's income under subsection 15(1). A number of the more common situations in which such a

benefit can arise are discussed. The shareholder benefit provision can also apply to a person who, at the time the benefit was conferred, was contemplated as becoming a shareholder.

The bulletin also discusses provisions that relate to a corporation's payment of a stock dividend, the forgiveness of a shareholder's obligation to a corporation, the goods and services tax component of a shareholder benefit, non-resident shareholder benefits, and other related provisions.

## ***Discussion and Interpretation***

### **Subsection 15(1)**

¶ 1. Under subsection 15(1), the amount or value of a benefit conferred on a shareholder by a corporation in a taxation year is included in the shareholder's income for the year, except to the extent that the benefit is deemed by section 84 to be a dividend. A benefit conferred by a corporation can also be included under subsection 15(1) in the income of a person who at the time the benefit was conferred was not a shareholder, if it was contemplated that the person would become a shareholder. Accordingly, the references throughout the rest of this bulletin to a "shareholder" include a "contemplated shareholder", where applicable. The word "benefit" in subsection 15(1) is broad enough to include

- (a) a payment by a corporation to a shareholder otherwise than pursuant to a bona fide business transaction;
- (b) an appropriation of a corporation's funds or other property in any manner whatever to, or for the benefit of, a shareholder; or
- (c) any other benefit or advantage conferred on a shareholder by a corporation.

If the person on whom the benefit has been conferred is both a shareholder and an employee of the corporation, a determination will have to be made, taking into consideration all the relevant facts and circumstances of the particular case, as to whether the benefit was conferred by the corporation on the person as a shareholder or as an employee. In the latter case, paragraph 6(1)(a) of the Act applies, rather than subsection 15(1).

¶ 2. A shareholder benefit cannot be included in income under subsection 15(1) if it falls within any of the exceptions described in paragraphs 15(1)(a) to (d). Thus, no amount is to be included in a shareholder's income under subsection 15(1) for any benefit occurring

- (a) on the reduction of a corporation's paid-up capital (paragraph 15(1)(a));
- (b) on the redemption, cancellation or acquisition by a corporation of its shares (paragraph 15(1)(a));
- (c) on the winding-up, discontinuance or reorganization of a corporation's business (paragraph 15(1)(a));

- (d) on the winding-up of a Canadian corporation or dissolution of a controlled foreign affiliate to which section 88 applies (paragraph 15(1)(a)); or
- (e) on the payment of a dividend or stock dividend (paragraph 15(1)(b); see, however, the rule discussed in 19 below).

Under the exception in paragraph 15(1)(c), no amount is to be included in a common shareholder's income under subsection 15(1) for any benefit resulting from a corporation's conferring on the shareholder a right to acquire an additional share or shares (common or otherwise) of the corporation, as long as the identical right is given to every other common shareholder for every common share owned by that other common shareholder. For purposes of the paragraph 15(1)(c) exception, that paragraph further provides two rules, the effects of which are as follows:

- Different classes of common shares are considered identical property where different voting rights are attached to each class but there are no other differences in their terms and conditions that could cause a material difference between the fair market values of shares of the different classes. This rule enables a corporation with voting and non-voting common shares to confer on shareholders of each class a right to acquire additional shares of that class without a subsection 15(1) benefit arising (i.e., if all the conditions for the paragraph 15(1)(c) exception are otherwise met).
- Rights are not considered identical if the cost of acquiring the rights differs.

Under the exception in paragraph 15(1)(d), no amount is to be included in a shareholder's income under subsection 15(1) for any benefit arising when an insurance corporation, bank or other corporation converts contributed surplus into paid-up capital in an action described in paragraph 84(1)(c.1), (c.2) or (c.3). Benefits resulting from transactions referred to in the above-mentioned exceptions to subsection 15(1) are in some cases taxed under other provisions.

¶ 3. The words "shareholder" and "corporation" are defined in subsection 248(1). The "taxation year" referred to in subsections 15(1) and 15(1.1) (see 19 below) is the taxation year of the shareholder and not that of the corporation.

¶ 4. Generally, when "property", as defined in subsection 248(1), is transferred by a corporation to or on behalf of a shareholder for inadequate consideration or no consideration, a benefit will have been conferred on the shareholder under subsection 15(1) unless one or more of the specific exceptions described in 2 above apply.

### **Bona Fide Transactions**

¶ 5. If a transaction involving a corporation and a shareholder is a bona fide business transaction, there is no subsection 15(1) benefit to the shareholder. Normally, a transaction is considered to be bona fide when its terms and

conditions are essentially the same as they would be if the transaction were entered into by parties dealing at arm's length.

## Exchange of Property

¶ 6. In an exchange of property between a corporation and a shareholder, whether by sale or otherwise, if the value of the property transferred by the corporation is more than the value of the property received by it from the shareholder, there is an appropriation of property for the benefit of the shareholder. The amount to be included in the shareholder's income under subsection 15(1) is the amount by which the fair market value, at the time of the exchange, of all the property transferred by the corporation exceeds the fair market value, at that same time, of all property received by the corporation, to the extent that the excess is not deemed to be a dividend by virtue of subsection 84(1).

## Shareholder's Transfer of Assets to a Corporation for Its Shares

¶ 7. A shareholder may sell or otherwise transfer assets to a corporation in a transaction in which the consideration received by the shareholder consists of or includes shares in the capital stock of the corporation. If the paid-up capital of the shares issued by the corporation exceeds the value of its net asset increase (if any), subsection 84(1) generally deems the amount of such excess to be a dividend received by all persons owning shares of the particular class and in proportion to their shareholdings. (A subsection 84(1) deemed dividend can occur where a subsection 85(1) election is made in connection with the transaction, although the effect, if any, of subsection 85(2.1) should be considered). In addition, if the fair market value of the consideration exceeds the fair market value of the assets sold or transferred, any such excess amount, except to the extent that it has been included in the shareholder's income under subsection 84(1), is generally included in the shareholder's income under subsection 15(1). The following example provides an illustration:

Assumptions: A taxpayer owns one third of the common shares in a corporation and is unrelated to and at arm's length with the corporation and the other shareholders. The taxpayer transfers land worth \$5,000 to the corporation for consideration consisting of newly created preferred shares in the corporation and cash of \$6,000. The preferred shares issued to the taxpayer have a paid-up capital of \$1,000 and a fair market value, as of the date of the transaction, of \$1,500. No subsection 85(1) election is made in connection with the transaction.

Results: The taxpayer is assessed a subsection 84(1) deemed dividend and a subsection 15(1) income amount as follows:

Subsection 84(1) deemed dividend:		
Increase in paid-up capital		\$1,000
Minus: Net asset increase to the corporation, if any (\$5,000 - \$6,000)		-----
Subsection 84(1) deemed dividend		<u>\$1,000</u>
Subsection 15(1) income amount:		
Fair market value of non-share consideration	\$6,000	
Fair market value of shares issued	<u>\$1,500</u>	\$7,500
Minus:		
Fair market value of assets transferred to the corporation	\$5,000	
Subsection 84(1) deemed dividend	<u>\$1,000</u>	<u>\$6,000</u>
Subsection 15(1) income amount		<u>\$1,500</u>

## Theft or Embezzlement by a Shareholder

¶ 8. Subsection 15(1) can apply even if the action or transaction involved is unauthorized, dishonest or illegal. The word "benefit" used in the subsection has a meaning wide enough to include, for example, funds or property of a corporation stolen or embezzled by a shareholder. However, as indicated in 1 above, the application of subsection 15(1) requires not only that there be a benefit to the shareholder but also that the benefit be conferred on the shareholder by the corporation. Where the shareholder and the corporation are not dealing at arm's length, the Department assumes that any appropriation or diversion of funds or property of the corporation to the shareholder would be with the concurrence of, and therefore would result in a benefit conferred by, the corporation. Where, on the other hand, the shareholder and corporation are dealing at arm's length, any theft or embezzlement of funds or property of the corporation by the shareholder would normally be without the concurrence of the corporation, in which case there would be no benefit conferred by the corporation (this could happen, for example, where the shareholder is a minority shareholder). Where a subsection 15(1) benefit does not occur, a theft or embezzlement is generally taxable in accordance with the rules discussed in the current version of IT-256, *Gains from Theft, Defalcation or Embezzlement*.

## Acquisition of Shares – Consideration Given by Corporation

¶ 9. Where a shareholder acquires the shares of another shareholder in a particular corporation, the circumstances surrounding the transaction may result in a subsection 15(1) benefit being conferred on the shareholder acquiring the shares. For example, the corporation may undertake to pay consulting fees or to make other payments for future services to the shareholder disposing of the shares (the ex-shareholder). If such payments by the corporation are in fact consideration for the shares sold, a benefit is considered

to have been conferred on the shareholder acquiring the shares in the year in which the corporation made the commitment to make the payments. There would be an indication that such an undertaking or commitment by the corporation is in fact consideration for the shares where the payments to the ex-shareholder must be made whether or not services are rendered to the corporation by the ex-shareholder.

### **Addition or Improvement to Shareholder's Building**

¶ 10. A corporation that is renting a building owned by a shareholder may make an addition or improvement to the building. If such an addition or improvement vests in the owner of the building, a benefit is considered to have been conferred on the shareholder by the corporation pursuant to subsection 15(1). The amount of the benefit is considered to be the present value of the amount, if any, by which the addition or improvement increases the value of the building to the shareholder at the time the building reverts to the shareholder. Therefore, in determining the amount of the benefit it is necessary to consider the particular facts of each case. The facts to be considered include the nature of the addition or improvement, the term of the lease, provisions for extension of the lease, provisions of the lease regarding leasehold improvements, and the amount of rent being charged. The benefit considered to be conferred in a particular taxation year is based upon the portion of the addition or improvement completed during that year. If the terms of the lease are later altered in favour of the shareholder, or if the lease is annulled before its term expires, a benefit would be created at that time equal to the increase in the shareholder's reversionary interest created by the alteration or cancellation of the lease.

### **Personal Use of Corporate Property by a Shareholder**

¶ 11. If corporate property is made available for the personal use of a shareholder, a benefit under subsection 15(1) is generally considered to have been conferred on the shareholder. This is so whether or not the shareholder has contributed to the cost of the property or has paid any related operating expenses. Also, the fact that the corporation has not claimed any capital cost allowance on the property is not relevant. The calculation of the amount or value of the benefit is usually based on the fair market rent for the property minus any consideration paid to the corporation by the shareholder for the use of the property. The fair market rent may not, however, always be appropriate for measuring the benefit, particularly where it does not provide for a reasonable return on the value or cost of the property. This may be the case, for example, for a luxury residence or yacht made available for the shareholder's personal use. See *Lloyd Youngman v. The Queen*, 90 DTC 6322, (1990) 2 C.T.C. 10. If the fair market rent is not an appropriate measure, or if it does not exist or cannot be determined, the amount or value of the benefit would then usually be determined by

multiplying a normal rate of return times the greater of the cost or fair market value of the property and adding the operating costs related to the property. The total of these two amounts is often referred to as the "imputed rent".

Any consideration paid to the corporation by the shareholder for the use of the property is then subtracted from the imputed rent. In applying this formula, the amount representing the greater of the cost or fair market value of the property may first be reduced by any outstanding interest-free loans or advances to the corporation made by the shareholder (in circumstances that are essentially the same as in the *Youngman* case) to enable the corporation to acquire the property, before multiplying by the normal rate of return.

### **Cost of Property Acquired by Shareholders**

¶ 12. Where an amount is included in the income of a resident shareholder pursuant to subsection 15(1) as a consequence of the acquisition of a capital property from a corporation, subsection 52(1) provides that such an amount is an addition to the cost to the shareholder of the property (except to the extent that such amount has otherwise been added to the cost or included in the adjusted cost base of the property). Subsection 52(1.1) contains a similar rule for a non-resident shareholder where the property acquired would, on disposition by the shareholder, be classed as taxable Canadian property. Since the rules in subsections 52(1) and 52(1.1) are only for the purpose of calculating capital gains or capital losses, they are not applicable where the property acquired by the shareholder is inventory or eligible capital property, nor do they affect the amount of capital cost for the purposes of capital cost allowances. Also, they do not apply where subsections 20(1) or 26(5) of ITAR applies to the transaction.

¶ 13. Where a corporation disposes of property to a shareholder at less than fair market value and paragraph 69(1)(b) applies to deem the corporation to have received proceeds of disposition equal to that fair market value, the Department may permit a corresponding adjustment to the shareholder's purchase price (e.g., in circumstances involving an honest error or a price adjustment clause). For more information, see the current version of IT-405, *Inadequate Considerations – Acquisitions and Dispositions*, and, where applicable, the current version of IT-169, *Price Adjustment Clauses*. If the Department does permit such an adjustment to the purchase price and the shareholder thus ends up paying the full fair market value (determined as of the date of the purchase) to the corporation for the property, there is no subsection 15(1) benefit to the shareholder.

### **No Deduction Allowed to the Corporation**

¶ 14. If an amount is included in the income of a shareholder under subsection 15(1), such amount is not allowed to the corporation as a deduction from income.

## Non-resident Corporation

¶ 15. Subsection 15(7) confirms that subsection 15(1) applies to a resident shareholder of a non-resident corporation whether or not the corporation was resident in Canada or carried on business in Canada.

## Benefits Resulting from Personal Use of Aircraft, the Availability of an Automobile or from an Interest-free or Low-interest Loan

¶ 16. For comments on shareholder benefits resulting from

- the personal use of aircraft,
- the availability of an automobile, or
- an interest-free or low-interest loan,

please see the current version of IT-160, *Personal Use of Aircraft*, IT-63, *Benefits, Including Standby Charge for an Automobile, from the Personal Use of a Motor Vehicle Supplied by an Employer*, or IT-421, *Benefits to Individuals, Corporations and Shareholders from Loans or Debt, respectively*.

## Related Provisions

¶ 17. The rules in subsection 15(1) are supplemented by, and should be read in conjunction with, the provisions in subsection 56(2) and subsections 246(1) and (2) in so far as they relate to indirect payments or transfers made by a corporation for the benefit of a shareholder or as a benefit that the shareholder desired to have conferred on some other person. Subsection 56(2) is discussed in the current version of IT-335, *Indirect Payments*.

## Co-operative Apartments

¶ 18. A number of individuals may form a corporation for the sole purpose of having the corporation own an apartment block. Each shareholder becomes entitled to occupy a specific suite in the apartment block. Generally, monthly service rates charged by the corporation to the shareholders are calculated so as to defray as nearly as possible the estimated cost of financing and operating the building. The intention of this arrangement is that the corporation does not have a profit or loss and the shareholders receive accommodation at actual cost. In these circumstances, while the shareholders are charged less by the corporation than the fair market rent, subsection 15(1) is not considered to apply to the shareholders nor is paragraph 69(1)(b) considered to apply to the corporation. The foregoing view will not be taken if the corporation accumulates surplus funds and the income earned on those funds is used to pay part of the operating costs of the building.

## Stock Dividends

¶ 19. As indicated in 2(e) above, subsection 15(1) cannot apply to any benefit resulting from a corporation's payment of a stock dividend. However, if it may reasonably be

considered that one of the purposes of the payment of the stock dividend was to significantly alter the value of the interest in the corporation of any specified shareholder of the corporation (e.g., to shift from one person to another the capital gain on a subsequent sale of shares), subsection 15(1.1) applies. Under that subsection, the fair market value of the stock dividend is included in the recipient shareholder's income except to the extent that it has otherwise been included in the shareholder's income as a taxable dividend under paragraph 82(1)(a). The term "specified shareholder" is defined in subsection 248(1).

## Obligations Settled or Extinguished

¶ 20. When a subsection 15(1) benefit is conferred on a shareholder by a corporation in connection with a loan or other obligation of the shareholder that is settled or extinguished without any payment or by payment by the shareholder of less than the amount of the obligation outstanding, subsection 15(1.2) applies. For the purposes of subsection 15(1), the value of the benefit is deemed by subsection 15(1.2) to be the amount by which the obligation outstanding at the time it is settled or extinguished exceeds the total of the following two amounts:

- (a) the amount, if any, of the benefit in respect of the obligation that was included in the income of the shareholder when the obligation arose, and
- (b) the amount, if any, paid by the shareholder on settlement.

*Note:* On December 20, 1994, the Minister of Finance released draft legislation on the income tax consequences of debt forgiveness and foreclosures. This legislation relates to measures announced in the Federal Budget of February 22, 1994. If enacted, the legislation would, among other things, do the following:

- Subsection 15(1.2) would be amended to provide that the value of a subsection 15(1) shareholder benefit in connection with an "obligation issued by a debtor" that is settled or extinguished at any time would be deemed to be the "forgiven amount" at that time in respect of the obligation.
- The "forgiven amount" for purposes of amended subsection 15(1.2) would be defined in new subsection 15(1.21). This definition would parallel the definition of "forgiven amount" in amended subsection 80(1), subject to certain modifications.
- New subsection 248(26) would clarify that a debtor's liability to repay borrowed money or to pay an amount (other than interest)
  - as consideration for any property acquired by the debtor or services rendered to the debtor, or
  - that is deductible in computing the debtor's income

would be considered to be an "obligation issued by the debtor". This rule would apply for purposes of

*applying the provisions of the Act (including amended subsection 15(1.2) and new subsection 15(1.21)) relating to the treatment of a debtor in respect of a liability. New subsection 248(27) would clarify the treatment of an obligation issued by a debtor that is or was part of a larger obligation issued by the debtor.*

- *An order would be created for applying certain provisions in the Act that pertain to debt, including amended subsection 15(1.2) and new subsection 15(1.21).*

*These amendments would generally apply to taxation years ending after February 21, 1994.*

## **Goods and Services Tax**

¶ 21. Subsection 15(1.3) provides that, to the extent that the amount or value of a subsection 15(1) benefit is determined by reference to the cost to a corporation of any property or service, such cost to the corporation shall not include any Goods and Services Tax (“GST”) payable by the corporation on that property or service.

¶ 22. Subsection 15(1.4) generally requires that an amount be included in a shareholder’s income which essentially represents the amount (if any) of GST that the shareholder would have paid had the shareholder purchased in the marketplace a property or service which results in a subsection 15(1) benefit or would have resulted in such a benefit had no payments been made to the corporation or to a person related to the corporation.

## **Deemed Dividend to a Non-resident**

¶ 23. For resident shareholders, amounts brought into income by virtue of section 15 are classified as income from property. For non-resident shareholders, paragraph 214(3)(a) deems such amounts to be a dividend to which the normal non-resident tax rules under Part XIII apply. Paragraph 214(3)(a) is for the purposes of Part XIII only. Consequently, the deemed dividend does not qualify as a dividend paid by the corporation for dividend refund purposes under subparagraph 129(1)(a)(i).

## *Explanation of Changes*

### Introduction

The purpose of the *Explanation of Changes* is to give the reasons for the revisions to an interpretation bulletin. It outlines revisions that we have made as a result of changes to the law, as well as changes reflecting new or revised departmental interpretations.

### Overview

This bulletin discusses the taxation of benefits conferred by a corporation on a shareholder or contemplated shareholder. It has been revised primarily to reflect relevant amendments and proposed amendments to the shareholder benefit provision and related provisions.

### Legislative and Other Changes

New ¶s 1 and 2 replace old ¶s 1, 2 and 9. New ¶s 1 and 2 reflect the amendments to subsection 15(1) that have resulted from the enactment of Bills C-139 and C-18 (these amendments took effect in 1988) as well as Bills C-92 and C-27 (these amendments took effect for benefits conferred after December 19, 1991).

New ¶ 3 is essentially the same as old ¶ 6 except that a reference has been added to paragraph 15(1.1), which became law by the enactment of Bill C-84 in 1986.

The following new paragraphs are essentially the same as the corresponding old paragraphs:

New ¶ 4	Old ¶ 11
New ¶ 5	Old ¶ 10
New ¶ 6	Old ¶ 14
New ¶ 7	Old ¶ 3
New ¶ 9	Old ¶ 19
New ¶ 10	Old ¶ 17
New ¶ 12	Old ¶ 12
New ¶ 13	Old ¶ 13
New ¶ 14	Old ¶ 8
New ¶ 15	Old ¶ 5
New ¶ 16	Old ¶ 16
New ¶ 18	Old ¶ 20
New ¶ 23	Old ¶ 4

New ¶ 8 replaces old ¶ 15. New No 8 reflects the provisions of subsection 15(1), as amended in 1988 by the enactment of Bill C-139.

New ¶ 11 is added to the bulletin. It is based on the Department's answer to question 33 of the 1987 Canadian Tax Foundation Round Table Discussion as well as on the Federal Court of Appeal's decision in *Lloyd Youngman v. The Queen*, 90 DTC 6322, (1990) 2 C.T.C. 10.

In new ¶ 17, which replaces old ¶ 7,

- the reference to old subsection 245(2) and (3), as they read prior to the enactment of Bill C-139 in 1988, has been removed, and
- a reference has instead been made to subsections 246(1) and (2), which were added to the Act by the enactment of Bill C-139.

New ¶ 19 has been added to the bulletin to discuss the rule contained in subsection 15(1.1), which was added to the Act by the enactment of Bill C-84 in 1986.

New ¶ 20 has been added to the bulletin to discuss the rule contained in subsection 15(1.2), which was added to the Act by the enactment of Bill C-64 in 1987. An italicized note at the end of ¶ 20 describes amendments to the Act, proposed in draft legislation released by the Minister of Finance on December 20, 1994, that relate to the application of subsection 15(1.2).

New ¶s 21 and 22 have been added to the bulletin to refer to subsections 15(1.3) and 15(1.4). Both subsections were added to the Act by the enactment of the GST legislation, effective for benefits conferred after 1990. ¶ 22 reflects the amendments to subsection 15(1.4) that resulted from the enactment of Bill C-92, the last of which took effect for the 1992 taxation year.

Old ¶ 18 is removed from the bulletin because the first part of that paragraph is outside the scope of a discussion on shareholder benefits and the second part is already covered by the comments in new ¶ 12.

Throughout the new bulletin, there are other changes or additions to the text which we have made solely to clarify or elaborate on the information given, without changing the substance of what was said in the old bulletin.

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<sup>1</sup> Added on April 23, 2004

<sup>2</sup> The *Contents* was moved up compared to the last publication of the bulletin in order for it to be in line with the new bulletin format used.