

NO.: **IT-99R5 (Consolidated)**

DATE: *See Bulletin Revisions section*

SUBJECT: **INCOME TAX ACT**  
**Legal and Accounting Fees**

REFERENCE: Paragraph 18(1)(a) (also sections 9 and 239; subsections 13(12), 20(9), and 40(1); paragraphs 6(1)(f), 6(1)(j), 8(1)(b) and (c), 20(1)(b), (e) and (cc), 56(1)(b), (l) and (l.1), 60(o) and (o.1) and the definitions of “cumulative eligible capital” and “eligible capital expenditure” in subsection 14(5) and “exempt income,” “retiring allowance,” and “salary or wages” in subsection 248(1))

Latest Revisions – ¶s 17 and 18

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#### *Bulletin Revisions*

## ***Application***

This bulletin is a consolidation of the following;

- IT-99R5 dated December 11, 1998; and
- subsequent amendments thereto.

For further particulars, see the “Bulletin Revisions” section near the end of this bulletin.

## ***Summary***

This bulletin contains a general discussion of the treatment for tax purposes of legal and accounting fees. The bulletin addresses a number of specific situations and explains when and how these fees may be deducted as an expense in earning income from a business or property, as well as from other sources of income. The limited circumstances in which legal and accounting fees may be deductible from employment income are discussed, as is the treatment of legal and accounting fees in certain capital transactions.

## Discussion and Interpretation

### General Deductibility

¶ 1. Except where there is a specific provision in the Act dealing with legal or accounting fees, such as paragraphs 8(1)(b) or 60(o.1) (see ¶s 22 to 27 below), legal and accounting fees are deductible only to the extent that they

- (a) are incurred for the purpose of gaining or producing income from a business or property, and
- (b) are not outlays of a capital nature, see ¶s 14 to 16 below.

¶ 2. Generally, legal and accounting fees are allowable deductions where they are incurred in connection with normal activities, transactions or contracts incidental or necessary to the earning of income from a business or property. A deduction may therefore be taken for legal and accounting expenses in connection with a broad range of routine business functions, such as

- (a) preparing contracts in relation to the sale of inventory,
- (b) obtaining security for and collecting trade debts owing,
- (c) preparing financial records and minutes of shareholders' and directors' meetings,
- (d) making annual corporate filings,
- (e) routine or regular audits of financial statements,
- (f) conducting appeals in respect of, for example, sales tax including Goods and Services Tax/Harmonized Sales Tax, excise, municipal, or property taxes, and
- (g) watching legislation (including customs and other regulations) affecting the business operations of the taxpayer.

See ¶s 6 to 8 below for comments on legal and accounting fees in connection with income and other taxes and government levies.

¶ 3. In limited circumstances, legal fees have been held to be deductible where they are incurred in connection with the defence by a taxpayer against a charge of performing illegal actions in the operation of a business or in defence of the day-to-day methods of carrying on business. See, for example, the decision of the Exchequer Court in *Rolland Paper Co. Ltd. v. MNR*, [1960] CTC 158, 60 DTC 1095, in which legal fees to defend against a successful prosecution for anti-competitive trade practices were allowed as a deduction. In each case, the issue of whether or not a payment of fees to defend against criminal prosecution can meet the conditions of deductibility set out in ¶ 1 above is a question of fact which depends upon the relationship of the conduct in question to the taxpayer's income-earning activities. (See also the comments in ¶ 33 below regarding prosecutions for tax evasion.)

¶ 4. Legal costs to prosecute or to defend most tort, contract or other civil claims arising in the ordinary course of business will generally be deductible. Subject to the comments in ¶ 8 below, if the taxpayer is successful in a

legal proceeding, the gross amount of the legal fees which are otherwise deductible must be reduced by any legal costs awarded by the court which are received by the taxpayer. The treatment of damages or settlements paid by a taxpayer is discussed in the current version of IT-467, *Damages, Settlements and Similar Payments*; fines and penalties are dealt with in the current version of IT-104, *Deductibility of Fines or Penalties*.

### Financing Expenses

¶ 5. Legal and accounting fees incurred in connection with

- (a) issuing bonds, debentures or mortgages,
- (b) borrowing money for certain business or property purposes,
- (c) incurring indebtedness that is an amount payable for certain business or property purposes, and
- (d) rescheduling or restructuring a debt obligation

may also be deductible within the limitations of paragraph 20(1)(e). The current version of IT-341, *Expenses of Issuing or Selling Shares, Units in a Trust, Interests in a Partnership or Syndicate and Expenses of Borrowing Money*, discusses this subject in more detail.

### Income Tax Returns

¶ 6. Reasonable fees and expenses incurred for advice and assistance in preparing and filing of returns for income tax purposes are normally deductible by virtue of section 9 and are not limited under paragraph 18(1)(a) in computing business or property income to which such tax returns relate. A taxpayer who is employed in connection with selling property or negotiating contracts and who is entitled to deduct expenses pursuant to paragraph 8(1)(f) (see the current version of IT-522, *Vehicle, Travel and Sales Expenses of Employees*), may deduct a reasonable amount paid during the year to comply with the requirement to file an income tax return.

¶ 7. Under paragraph 60(o), all taxpayers, including those persons who report income from sources other than business or property (such as salary or capital gains), may deduct fees or expenses incurred and paid for advice or assistance in preparing, instituting or prosecuting an objection or appeal in respect of

- (a) an assessment of tax, interest or penalties under the *Income Tax Act* or a similar provincial law,
- (b) a decision of the Canada Employment and Immigration Commission, the Canada Employment and Insurance Commission, or a board of referees or an umpire under the *Unemployment Insurance Act* or the *Employment Insurance Act*,
- (c) an assessment of income tax, interest or penalties levied by a foreign government or political subdivision thereof, if the tax is eligible for a foreign tax credit, or
- (d) an assessment or decision under the Canada Pension Plan or a similar provincial plan.

A taxpayer may deduct amounts expended in connection with legal and accounting fees incurred for advice and assistance in making representations after having been informed that the taxpayer's income or tax for a taxation year is to be reviewed, whether or not a formal notice of objection or appeal is subsequently filed.

¶ 8. Any costs awarded or reimbursed to a taxpayer in respect of expenses deducted or deductible under paragraph 60(o) must be included in income by virtue of paragraph 56(1)(J) for the year in which the award was received. As indicated in ¶ 4 above, where other legal and accounting expenses were deducted under the general provisions of the law, any recovery of such expenses will reduce the expenses originally allowed.

### Advance Income Tax Rulings

¶ 9. The cost of advance income tax rulings include the following:

- (a) the cost of preparing an advance ruling request letter to Revenue Canada, including out-of-pocket expenses to prepare additional copies of documents,
- (b) the cost of attending interviews with rulings officers of the Department, and
- (c) Revenue Canada's charge for the ruling.

Such costs may be deductible under certain conditions within the provisions of the Act. Where the transactions proposed in the advance ruling request are of an income nature, the costs may be deductible by virtue of section 9 and are not limited under paragraph 18(1)(a), provided that the proposed transactions are for the purpose of gaining or producing income from a business or property. If the transactions proposed in the advance ruling request are of a capital nature, the advance rulings costs may be deducted within the provisions of paragraph 20(1)(cc) (see ¶s 11 to 13 below), provided the proposed transactions relate to a business carried on by the taxpayer.

The costs of obtaining an advance ruling are generally accepted as being a cost related to the business of a taxpayer even though there may be some argument that the proposed transactions themselves do not relate to a particular business carried on by the taxpayer. For example, an advance ruling may involve the incorporation of a new subsidiary corporation or an estate freeze which involves a new corporation. The costs of such a ruling would generally be deductible under paragraph 20(1)(cc).

¶ 10. The cost of advance rulings as described in ¶ 9 above do not include "transaction costs" which would have been incurred whether or not an advance ruling had been requested. Transaction costs include

- (a) the fees of legal, accounting and other consultants relating to the structuring of the transactions,
- (b) the cost of negotiating contracts, and
- (c) the cost of obtaining letters patent, supplementary letters patent, amendments to them, etc.

The deductibility of transaction costs will depend on the nature of the underlying transactions (as income or capital) and the applicability of the provisions of paragraphs 18(1)(a), 18(1)(b), 20(1)(e), or 20(1)(cc), or the definition of "eligible capital expenditure" in subsection 14(5), as the case may be.

### Expense of Representation

¶ 11. Paragraph 20(1)(cc) allows a deduction to a taxpayer for certain expenditures, generally of a capital nature, incurred and paid in making any representation relating to a business carried on by the taxpayer (including any representation made for the purpose of obtaining a licence, permit, franchise, patent, or trademark) to a government or public body or to a regulatory agency thereof. Expenses of litigation are not allowable deductions under this paragraph since a court of law does not form part of a government, nor is it a public body performing the function of a government. Also not deductible are expenses incurred (including legal fees) to negotiate with, for example, a manufacturer for an exclusive right or licence to handle the manufacturer's products in a specified territory. Since a representation must be related to a business carried on by the taxpayer, an expense incurred prior to the taxation year in which the taxpayer commenced business operations is not deductible under paragraph 20(1)(cc). A discussion of when a business commences is contained in the current version of IT-364, *Commencement of Business Operations*.

¶ 12. Pursuant to subsection 20(9), a taxpayer who is entitled to deduct an amount under paragraph 20(1)(cc) may in lieu of that deduction elect in the manner prescribed in Part XLI of the *Income Tax Regulations* to deduct one tenth of the amount in each of the ten consecutive years beginning with the year in which the expenditure is made.

¶ 13. Where a deduction under paragraph 20(1)(cc) or subsection 20(9) is taken and the cost of representation is on account of the capital cost of depreciable property, subsection 13(12) deems the amount to have been deducted as capital cost allowance. The effect of this deeming provision is to render any amount so deducted under paragraph 20(1)(cc) or subsection 20(9) liable to recapture in the event of a subsequent sale of the property.

### Capital Expenditures

¶ 14. Legal and accounting fees incurred on the acquisition of capital property are normally included as part of the cost of the property. In the case of depreciable property, the claim for capital cost allowance is based on the total capital cost including such fees. Pursuant to subsection 40(1), any outlay or expense (including legal or accounting fees) incurred for the purpose of making the disposition of a property is added to the adjusted cost base of the property in calculating the amount of the capital gain, capital loss, terminal loss or business investment loss, as the case may be, arising from the disposition.

## Eligible Capital Expenditures

¶15. Legal and accounting fees that are “eligible capital expenditures” within the meaning of that term in subsection 14(5) are included in the “cumulative eligible capital,” of the taxpayer in the manner provided in subsection 14(5) (see the current version of IT-143, *Meaning of Eligible Capital Expenditure*). A deduction in respect of such expenditures is allowed under paragraph 20(1)(b). Legal and accounting fees directly associated with the purchase of goodwill qualify as eligible capital expenditures. Where, however, an expenditure is deductible under some provision of the Act other than paragraph 20(1)(b) or is added to the cost of property (see ¶14 above), it does not qualify as an eligible capital expenditure.

## Corporate Take-overs

¶16. Legal and accounting costs incurred to fight a bid to take over control of a corporation are not deductible as current expenses or as eligible capital expenditures. Such costs relate to the ownership of the shares themselves (that is, the capital structure of the corporation) and are not laid out for the purpose of gaining or producing income from a business. Legal and accounting costs incurred in successful corporate acquisitions will generally be capital expenditures which may be added to the cost base of the shares acquired. The treatment of legal and accounting fees in the case of abortive attempts to acquire shares is discussed in the current version of IT-143, *Meaning of Eligible Capital Expenditure*. That bulletin also deals with the legal and accounting expenses of incorporation, reorganization and amalgamation.

## Support Amounts

¶17. Legal costs incurred in establishing the right to spousal support amounts, such as the costs of obtaining a divorce, a support order for spousal support under the *Divorce Act* or a separation agreement, are not deductible as these costs are on account of capital or are personal or living expenses. However, since children have a pre-existing right, arising from legislation, to support or maintenance, legal costs to obtain an order for child support are deductible. Legal costs of seeking to obtain an increase in spousal or child support, or to make child support non taxable under the *Federal Child Support Guidelines*, are non-deductible.

¶18. Legal costs incurred to enforce pre-existing rights to interim or permanent support amounts are deductible. A pre-existing right to a support amount can arise from a written agreement, a court order or legislation such as sections 11 and 15.1 of the *Divorce Act* with respect to child support, or Part III of the *Family Law Act* of Ontario, and enforcing such a right does not create or establish a new right; see *The Queen v. Burgess*, [1981] CTC 258, 81 DTC 5192 (F.C.T.D.). In addition, legal expenses incurred to defend against the reduction of support payments are deductible since the expenses do not create any new rights to income; see *The Attorney General of Canada v. Norma*

*McCready Sembinelli*, [1994] 2 CTC 378, 94 DTC 6636 (FCA.).

¶19. The legal costs described in ¶18 above are deductible even though an amount received as a “child support amount,” as described in subsection 56.1(4), is not included in the income of the recipient. While “exempt income” in subsection 248(1) is defined as property received or acquired that is not included in income, the definition excludes “support amounts”; therefore, the deduction of costs incurred in respect of support amounts is not denied by virtue of paragraph 18(1)(c) as being exempt income. For a discussion of “support amount” and “child support amount,” see the current version of IT-530, *Support Payments*.

¶20. A person who incurs legal expenses is not entitled to deduct them when they are incurred in connection with the receipt of a lump sum payment which cannot be identified as being a payment in respect of a number of periodic payments of support amounts that were in arrears. The lump sum payment however is generally not required to be included in income.

¶21. From the payer’s standpoint, legal costs incurred in negotiating or contesting an application for support payments are not deductible since these costs are personal or living expenses. Similarly, legal costs incurred for the purpose of terminating or reducing the amount of support payments are not deductible since success in such an action does not produce income from a business or property. Legal expenses relating to obtaining custody of or visitation rights to children are also non-deductible.

## Collection of Salary and Wages

¶22. Paragraph 8(1)(b) permits a deduction in computing income from an office or employment, for legal expenses paid by a taxpayer in the year to collect or to establish a right to salary or wages owed by an employer or former employer. Paragraph 6(1)(j) requires a taxpayer to include in income any award or reimbursement received in respect of amounts for which a deduction under paragraph 8(1)(b) is available. These amounts must be included in income to the extent that they are not otherwise so included or taken into account in computing the amount deducted under subsection 8(1).

¶23. A deduction under paragraph 8(1)(b) is allowed only in respect of an amount “owed” by an employer or a former employer. If the taxpayer is not successful in court or otherwise fails to establish that some amount is owed, no deduction for expenses is allowed. However, failure to collect an amount established as owed to the taxpayer does not preclude a deduction under this paragraph. Pension benefits and retiring allowances do not come within the definition of “salary or wages” in subsection 248(1); legal expenses in respect of such income are discussed in ¶s 25 to 27 below.

¶24. Paragraph 8(1)(b) does not permit a deduction for legal fees paid to obtain benefits under a “wage loss replacement plan” as described in the current version of

IT-428, *Wage Loss Replacement Plans*. While the amount received under a wage loss replacement plan is included in income under paragraph 6(1)(f) and therefore falls within the definition of “salary or wages” in subsection 248(1), the benefit is generally received from an insurer and the insurer is not the “employer or former employer” referred to in subsection 8(1)(b).

## Retiring Allowances and Pension Benefits

¶ 25. Within the limits set out in paragraph 60(o.1), a taxpayer may deduct legal expenses paid to collect or establish a right to a pension benefit or retiring allowance. The term “retiring allowance” is defined in subsection 248(1) and is broad enough to include damages or settlements for wrongful dismissal of the taxpayer (see also the current version of IT-337, *Retiring Allowances*). Legal fees to collect or to establish a right to a pension benefit or retiring allowance of a deceased individual are also eligible expenses under paragraph 60(o.1) where the taxpayer who made the payment and who claims the deduction was a dependant, relation or legal representative of the deceased. Eligible legal expenses under paragraph 60(o.1) do not include legal expenses relating to a division or settlement of property arising out of, or on a breakdown of, a marriage. By virtue of paragraph 252(4)(b), the breakdown of a marriage includes the breakdown of a conjugal relationship between two parties described as spouses of each other in paragraph 252(4)(a). Legal fees in respect of benefits under the *Canada Pension Plan* or similar provincial plan are not eligible under paragraph 60(o.1), but a deduction for such expenses may be available under paragraph 60(o) (see ¶s 7 and 8 above).

¶ 26. The amount of the eligible legal fees paid that may be deducted under paragraph 60(o.1) is limited to the following amount:

(a) the amount of any retiring allowance or pension benefit related to those legal fees which is received and included in the taxpayer’s income for the year or a previous year,

plus

(b) any reimbursement of legal expenses included in the taxpayer’s income under paragraph 56(1)(l.1) (see ¶ 27 below) for the year or a preceding year,

minus

(c) transfers to a Registered Pension Plan or Registered Retirement Savings Plan deducted pursuant to paragraphs 60(j), (j.01), (j.1) or (j.2); this reduction is only required to be made to the extent that the amounts so transferred are amounts for which legal expenses eligible for deduction under paragraph 60(o.1) were incurred.

Only legal fees paid in connection with the income described above are eligible for deduction. Any otherwise eligible legal fees which are not deductible because they exceed such income may be carried forward and may be deducted in any of up to seven subsequent years, to the extent that further

related income arises and to the extent that the amounts in question were not previously deductible.

¶ 27. Under paragraph 56(1)(l.1), amounts received by the taxpayer as an award or reimbursement of the types of eligible legal expenses described in ¶s 25 and 26 above must be included in income. This inclusion in income may be offset by the deduction available under paragraph 60(o.1).

### Example

In 1994, Mr. Superannuate incurred legal expenses of \$3,000 and, in 1995, an additional \$6,000 in an attempt to establish a right to receive a retiring allowance from his former employer.

In 1996, he incurred further legal expenses of \$1,000 to establish his right to and to collect a retiring allowance. In 1996, Mr. Superannuate’s former employer paid him a retiring allowance of \$15,000 and a \$7,500 reimbursement of legal expenses and agreed to pay him further retiring allowances of \$10,000 in 1997 and \$5,000 in 1998. Mr. Superannuate transferred the \$15,000 received in 1996 to his RRSP.

In 1997, Mr. Superannuate received \$10,000 under the agreement with his former employer and he transferred it to his RRSP.

In 1998, Mr. Superannuate received the final \$5,000 under the agreement with his former employer and he transferred \$2,500 of it to his RRSP.

In 1994 or 1995, Mr. Superannuate was not entitled to deduct any of the legal expenses that he incurred to establish a right to a retiring allowance because he had not received a reimbursement of those legal expenses or a retiring allowance in either of those years.

In 1996, Mr. Superannuate is required to include the \$7,500 reimbursement of legal expenses in income pursuant to paragraph 56(1)(l.1). While he has incurred legal expenses of \$10,000 in establishing the right to, and collecting the retiring allowance, his deduction under paragraph 60(o.1) is limited to \$7,500—the aggregate of the retiring allowance received in the year and the reimbursement of legal expenses, less the amount transferred to his RRSP. The \$2,500 of legal expenses that were not deductible in 1996 may be carried forward and deducted in later years to the extent that Mr. Superannuate receives a further retiring allowance or reimbursement of legal expenses from his former employer and to the extent that those payments can be associated with the legal expenses incurred in 1994 to 1996.

In 1997, Mr. Superannuate was unable to deduct any part of the \$2,500 in legal expenses that he carried forward since he transferred all of the retiring allowance that he received in that year into his RRSP.

In 1998, pursuant to paragraph 60(o.1), Mr. Superannuate will be able to deduct the \$2,500 of legal expenses that he carried forward since he transferred only \$2,500 of the retiring allowance that he received in that year into his RRSP.

## “Legal” Fees in Paragraphs 8(1)(b) and 60(o.1)

¶ 28. It is not always necessary that the fees relating to matters described in paragraphs 8(1)(b) or 60(o.1) be paid to a lawyer. For example, an employee whose services are being terminated could obtain the services of a consultant in labour relations to negotiate a severance package. The fees paid to the consultant in that case will be accepted as legal fees, deductible under paragraph 8(1)(b) or 60(o.1), depending on the circumstances.

## Employees Selling Property or Negotiating Contracts

¶ 29. An employee who is entitled to deduct expenses pursuant to paragraph 8(1)(f) (see the current version IT-522, *Vehicle, Travel and Sales Expenses of Employees*) may deduct reasonable amounts paid during the year in respect of legal costs arising from an event that by its nature is a risk normally incidental to the income earning activity. For example, a real estate agent may deduct legal fees in a defence against charges of misrepresentation in connection with an aborted sale of property. The legal expenses would not be deductible, however, if they were of either a capital or personal nature. An outlay incurred to protect the agent’s licence to earn real estate commissions and an outlay directly attributable to an automobile accident which occurred while the automobile was being used for personal purposes are examples of expenditures of a capital and personal nature, respectively.

## Legal Expenses of Employees Paid by Employers

¶ 30. An employer may deduct the legal expenses incurred in defending an employee, officer or director against charges of having committed an illegal or wrongful act in the ordinary course of carrying on the employer’s business. This could include expenses incurred in relation to allegations of offences under business practices or competition law. See for

example, the criteria set out in *The Car Strip Ltd. v. MNR*, [1967] Tax A.B.C. 361, 67 DTC 259 and the decision of the Federal Court, Trial Division, in *Border Chemical Company Ltd. v. The Queen*, [1987] 2 CTC 183, 87 DTC 5391.

¶ 31. An employer may deduct premiums under an insurance policy which provides for the reimbursement of legal expenses incurred by officers or directors in defending themselves against claims made against them by reason of their positions with the employer.

¶ 32. Where personal legal expenses of an employee (or of his or her family) are paid or reimbursed by the employer, the amount paid is a taxable benefit to the employee. To the extent that the amount so paid does not exceed a reasonable amount, it will normally be deductible to the employer as a business expense on account of the employee’s wages or benefits.

## Criminal Prosecutions Under Section 239

¶ 33. Legal and accounting fees incurred in connection with a prosecution under section 239 (tax evasion) are generally not allowable expenses since in most cases they are not laid out to earn income. These fees are not deductible under paragraph 60(o) inasmuch as the information laid with respect to the charge is not an assessment within the meaning of that paragraph. Pursuant to the comments in the current version of IT-104, *Deductibility of Fines or Penalties*, any fine in such a situation would not be deductible either. However, in limited circumstances, such as those in *Ben Matthews & Associates v. MNR*, [1988] 1 CTC 2372, 88 DTC 1262 (T.C.C.), legal and accounting fees incurred to defend against a section 239 prosecution may be considered to have been laid out to earn income. These expenses may be allowable deductions where they can be shown to relate to the defence of practices which arise in the normal course of the taxpayer’s income-earning activities, such as the manner of preparing financial records, provided that there has been full disclosure of information by the taxpayer.

## ***Bulletin Revisions***

¶s 1 to 16 and 19 to 33 have not been changed since the issuance of IT-99R5 dated December 11, 1998.

¶s 17 and 18 have been revised to clarify that legal fees incurred in establishing the right to spousal support under the *Divorce Act* are not deductible. For greater certainty, the

Canada Customs and Revenue Agency accepts the position that children have a pre-existing right, arising from legislation, to maintenance regardless of whether the support is obtained pursuant to the *Divorce Act* or provincial legislation. [December 5, 2000]

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