

Marmar Penner Newsletter

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LEGAL FEES:

GREATER DEDUCTIBILITY MAKES THEM LESS EXPENSIVE

The deductibility of legal fees incurred as a result of marital breakdown contains numerous grey areas. Much has been written on the issue of deducting legal fees relating to support, but little has been written about legal fees pertaining to property and issues of other types of income. The following case provides an example where in the opinion of the Tax Court of Canada, significant legal fees unrelated to support incurred by one spouse were allowed as tax deductible.

The appeal to the Tax Court was made by Lela Kornberg, who was married to Harvey Kornberg and separated

from him in 1987. She was a shareholder and officer or director of a number of corporations carrying on business in Manitoba, Saskatchewan and Minnesota. She did not exercise day-to-day control over the management of any of the corporations. Companies owned or controlled by Harvey were responsible for the management, direction and operation of Lela's corporations. After separation, Lela's concerns regarding how the companies were being managed led her to take certain steps and commence certain legal proceedings.

Lela owned 50% of the Saskatchewan corporation involved in the development of a

condominium project in Regina. She became dissatisfied with the management services provided by Harvey's company because of a failure to provide written quarterly reports, the refusal of Harvey's corporation to sign a form of renewal of an existing line of credit, the failure to effect sales of the project in an appropriate manner, and the failure to devote sufficient time and effort to sales and management obligations.

With respect to her Manitoba corporation, a number of similar issues arose. In addition, Lela incurred legal fees in order to force Harvey to produce certain financial records of her company.

With respect to her Minnesota corporation, Lela instituted action against Harvey and other defendants demanding access to records and documents of the company, and alleging Harvey's improper actions in his managerial capacity.

She claimed that Harvey was mismanaging the corporation, misapplying or wasting its assets, and engaging in conduct as manager which was fraudulent, illegal, negligent or unfairly prejudicial to her interest.

In total, Lela sought to claim \$110,000 of deductible legal fees. The court was advised that these legal fees did not include fees paid to her family lawyer with respect to the "divorce, maintenance, et cetera". Lela's counsel argued she was entitled to receive money in

respect to her shareholdings. The object of her legal actions was to rectify that situation. He stated that the only way to do so was to review the management records, look at the companies, and "get her a monthly income". Her counsel submitted that she was not defending her title to the shares and that the legal steps she took were not incurred for the purpose of establishing any new asset or right. Counsel for the Minister of Revenue submitted that there was no proof of any of the allegations Lela made against Harvey, that the actions established nothing, and had, as their purpose, the resolution of this matrimonial dispute. The Honourable Justice Bell concluded that

Lela's legal expenses were deductible as they were incurred with the hope of obtaining income by way of dividends on her shares. In many matrimonial disputes, one spouse may have an ownership interest in a business notwithstanding that this spouse is not actively involved in operation of the business. As a result, significant legal and accounting fees may be incurred in order to gain a better understanding of the business and determine whether an appropriate return is being paid on the shares held. As a result of the decision in *Kornberg v. the Queen* (97 DTC 1459), professional fees incurred for such a purpose may be deductible.