

Foreign Exchange Gains, Convertible Debentures, and Currency Fluctuations

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Agnico-Eagle Mines Limited v The Queen, [2014 TCC 324](#)

Agnico is a taxable Canadian corporation. It issues US-denominated convertible debentures (in 2002), and converted and redeemed these debentures into common shares in 2005 and 2006.

At issue was whether, due to the fluctuation of the exchange rate, Agnico realized a foreign exchange gain when the debentures were converted and redeemed for common shares. This is the first time a Canadian court has considered this issue.

POSITIONS

The MNR's position was that, because the conversion and redemptions resulted in a reduced repayment of the debt principal (equal to its US dollar amount converted into Canadian dollars), a foreign exchange gain resulted. In other words, because the taxpayer was able to discharge its liability for less, in Canadian dollar terms, a gain resulted.

The Taxpayer argued that (a) the principal amount of the debt became irrelevant when holders exercised their conversion feature (as most did), and (b) that no gain can be realized as they paid out more (in value of common shares) than they had borrowed.

ANALYSIS

A foreign exchange gain/loss is realized upon the repayment of a debt denominated in foreign currency, whether or not there is an actual conversion of borrowed funds into Canadian dollars. Where a gain is realized because of foreign currency fluctuations, the gain is deemed to be a capital gain on the disposition of foreign currency (subsection 39(2)). Where there is no actual conversion of the foreign currency, the amount is translated into Canadian dollars at the relevant spot rates (subsection 261(2)).

In relation to the conversion of the debentures into common shares, the Court looked at the amounts received for the issuance of the convertible debentures and the amounts paid for the extinguishment of the debentures on conversion (in Canadian dollars). The Court noted that from an economic standpoint, the taxpayer incurred an aggregate loss (when comparing the amount received for the debentures and the amount paid out in common shares). However, the amount paid out on conversion is not necessarily reflected in the trading price, but is the amount for which the common shares were issued: *Teleglobe Canada Inc. v The Queen*, [2002 FCA 408](#) ; *King Rentals Ltd. v The Queen*, 96 DTC 1132 (TCC).

The amount for which the shares are issued is determined by agreement of the parties, and may be reflected in the stated capital account (*Teleglobe*). The transaction documents set out

that the common shares would be issued at an amount that equaled the principal amount of the debentures in US dollars. But this must be converted into Canadian dollars (subsection 261(2)).

The conversion into Canadian dollars must be made when the amounts "arose" - but is this when the amount was paid for the convertible debenture, or when the debt was extinguished? The Court held that the relevant date is when the consideration for the common shares was received by the corporation - in this case the date on which the convertible debentures were issued, as this is when the true consideration for the common shares was received. The court was very careful to state that this is dependent on the facts of each case (para 62). The court based the conclusion on the fact that the amount of common shares receivable on conversion was determined at the time of the issuance of the debentures, and linked to the principal amount of the debenture.

Thus, because the relevant date is the same date, no foreign exchange gain arose.

In relation to the redemption of the debentures with payment in common shares, the court agreed with the MNR that a foreign exchange gain was realized as the amount paid on redemption was based on the principal amount, and the principal amount had decreased in Canadian dollar terms (paras 72-73). This was because the indenture pegged the redemption price to the principal and unpaid interest (not the fair market value at the date of redemption), and made the amount payable on the redemption date (para 73).

- Sas Ansari

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