Look Back Renunciations for Flow-Through Shares

Author : admin

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Tusk Exploration Ltd v The Queen, 2016 TCC 238

At issue was whether a corporation making a look-back renunciation under subsection 66(12.66) has to pay Part XII.6 tax on the amount where the renunciations are invalid.

FACTS

The Appellant, a mineral exploration CCPC, issued flow-through shares to investors. It renounces Canadian Exploration Expenses to these flow-through shareholders, many on a look-back basis pursuant to subsection 66(12.66) of the *Income Tax Act*.

The corporation and shareholder did not deal with each other at arm's length in this case.

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ANALYSIS

Flow-through shares assist with the financing of exploration activities by allowing investors to claim tax deductions for expenses incurred by the corporation. The ITA imposes a number of conditions on the issuance of flow-through shares (s 66(15)) and renunciation of Canadian exploration expenses (s 66(12.6)). Expenses that are renounced are deemed to have been incurred by the shareholder and not to have been incurred by the corporation (s 66(12.61). Usually, only expenses incurred on the effective date of the renunciation may be renounced.

ITA subsection 66(12.66) allows shareholders to take a deduction in the year PRIOR to the expenses being incurred, resulting in the corporation being deemed to have incurred the expenses on the last day of the year in which they are claimed IF all the statutory conditions are met. One condition is that the corporation and shareholder deal with each other at arm's length (ITA para 66(12.66)(d)). The other conditions include that the flow-through share agreement be made in the year prior to the expenses being incurred, the consideration be paid before the end of the preceding year, the expenses qualifying as CEE or CDEs, and the renunciation be made in January, February, or March.

A corporation making a look-back renunciation must file a return and pay Part XII.6 tax (ITA section 211.91). The tax is payable where the corporation has "purported to renounce" expenses. There is an additional tax of 10% on amounts purportedly renounced but not incurred by the end of the calendar year of renunciation.

The Court noted that subsection 66(12.66) is a deeming provision that operates when the listed conditions are met. The tax under section 211.19 applies on amounts a corporation has "purported to renounce" (para 40). The phrase has to be interpreted in a textual, contextual, and purposive manner (*Canada Trustco Mortgage Co v The Queen*, 2005 SCC 54 at paragraph 10, *Placer Dome Canada Ltd v Ontario (Minister of Finance)*, 2006 SCC 20 at paragraphs 21-22).

The Court held that "purport" in this context must be taken to refer to the amount claimed to be renounced or intended to be renounced, whether or not the claim is true or not (para 42). This is supported by the french words that translate to "supposedly renounced" or "apparently renounced" (para 42). Requiring effective renunciation would render the word used by Parliament redundant, making such an interpretation counter to the rule against tautology - *Canada (Canadian Human Rights Commission) v Canada (Attorney General)*, 2011 SCC 53 at paragraph 38.

This interpretation is also supported by other provisions that contrast "purported" renunciations with amounts the corporation "can renounce" (paras 48-49), as well as those dealing with excessive renunciations (para 50). Additionally, the purpose of Part XII.6 tax is to compensate the fisc for the acceleration of the deduction (para 53).

The Court recognized that this may be punitive to non-arm's length shareholders, but this outcome in intentional in the ITA. No interest relief would be available to such shareholders under subsection 161(6.2).

Sas Ansari, BSc BEd PC JD LLM PhD (exp) CPA In-Depth Tax 1, 2 &3

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