Canada Revenue Agency / Agence du revenu du Canada

MAY 31 2012

Robin J. MacKnight
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2012-044115

May 24, 2012

Dear Mr. MacKnight:

Re: Donation of flow-through shares

We are writing in response to your letter dated March 5, 2012 and our subsequent phone discussion of March 26, 2012 (MacKnight/[redacted]) concerning a gifting arrangement involving publicly-listed shares issued by a Canadian resident resource corporation ("ResCo"), pursuant to a flow-through share agreement, to investors consisting of various individuals and private corporations ("PrivCos") who are resident in Canada. In this regard, you advise that each issued share would qualify as a "flow-through share" ("FTS") under subsection 66(15) of the *Income Tax Act* (the "Act").

Briefly, as you described in your letter, immediately after the income tax benefits relating to the renunciation of qualifying resource expenses by the ResCo are realized, each investor may gift the FTS to a registered charity or sell the FTS. You have requested our comments on the income tax consequences relating to the disposition of the FTS, by way of gift. In particular, you have requested our comments on the application of subsection 40(12) of the Act to the investors and the impact to the PrivCos' "capital dividend account" ("CDA") as defined in subsection 89(1) of the Act.

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Our Comments

<u>Donation of FTS</u>

In general, paragraph 38(a) of the Act provides that a taxpayer's taxable capital gain from the disposition of property as one-half (1/2) of the taxpayer's capital gain for the year from the disposition of the property. However, under subparagraph 38(a.1)(i) of the Act, the taxable capital gain resulting from the making of a gift to a qualified donee of certain types of securities such as a publicly-listed FTS is equal to zero. A qualified donee is defined in subsection 149.1(1) of the Act and includes registered charities.

Similarly, under subparagraph 38(a.1)(iii) of the Act, the taxable capital gain on the exchange of unlisted shares for securities described in subparagraph 38(a.1)(i) of the Act is equal to zero, where

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- the exchanged shares included, at the time they were issued, a condition allowing the holder to exchange them for the securities;
- the securities are the only consideration received on the exchange; and
- the securities are donated to a qualified donee within 30 days of the exchange.

Whether a gain on the disposition of a property is on account of income or on account of capital is generally a question of fact that can only be determined on a case-by-case basis.

Under recently enacted[i] subsection 40(12) of the Act, generally, where a taxpayer disposes of one or more capital properties included in a "flow-through share class of property" to a qualified donee and subparagraph 38(a.1)(i) or (iii) of the Act applies to the disposition, the taxpayer will be deemed to have an additional capital gain from the disposition of another property equal to the lesser of:

- the amount of the taxpayer's "exemption threshold" in respect of the "flow-through share class of property"; and
- the total capital gains from the disposition of the actual property.

As a result, the taxpayer will report, in computing income, a taxable capital gain equal to one-half (1/2) of this additional capital gain.

Generally, a "flow-through share class of property" as defined in section 54 of the Act, is a group of properties, comprised of all shares of a class if any share in the class is a FTS to any person. Both FTS and property identical to them are included in a "flow-through share class of property". The definition also includes rights to acquire a share of such a class, and property identical to such rights. A flow-through share class of property will also include a group of properties, each of which is an interest in a partnership, if at any time more than 50% of the fair market value of the partnership's assets is attributable to property included in a flow-through share class of property.

Generally, under section 54 of the Act, a taxpayer's "exemption threshold" at a particular time in respect of a particular flow-through share class of property is the amount by which:

- the sum of the original cost to the taxpayer of all FTS of the particular class (determined without regard to the deemed zero-cost of FTS under subsection 66.3(3) of the Act) issued to the taxpayer on or after the taxpayer's "fresh-start date" and before the particular time,

  exceeds

- the amount of each capital gain realized by the taxpayer on a disposition, after the taxpayer's "fresh-start date" and before the particular time, of any FTS of the flow-through share class of property, not exceeding the amount of the exemption threshold immediately before the time of disposition.

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Pursuant to the definition of "fresh-start date" in section 54 of the Act, the fresh-start date of a taxpayer at a particular time in respect of a flow-through share class of property is, except in the case of a partnership interest, the day that is the later of March 22, 2011, and the last day, if any, before the particular time, on which the taxpayer disposed of a property that is included in the flow-through share class of property and at the end of which the taxpayer held no such property.

In the circumstances described, to the extent that a taxpayer has acquired publicly-listed shares issued pursuant to a FTS agreement entered into on or after March 22, 2011 (and in respect of which the taxpayer may become entitled to a deduction in computing income) and provided that such shares are held as capital property, the taxpayer will be required, by virtue of subsection 40(12) of the Act, to pay tax at normal capital gains rates on capital gains realized on the donation of those shares to a qualified donee. Those capital gains will reduce the balance of the taxpayer's exemption threshold. To the extent that the exemption threshold is reduced to nil, a capital gain from the donation of the FTS to a qualified donee is exempt from tax.

Capital dividend account

In general, the CDA keeps track of various tax-free surpluses accumulated by a private corporation. The rules for determining the balance in the CDA of a private corporation are provided in the definition of that term in subsection 89(1) of the Act and are calculated on a cumulative basis for a particular period.

Generally, under paragraph (a) of the CDA definition, the non-taxable portion of capital gains that exceeds the non-deductible portion of capital losses in respect of dispositions of capital property by a private corporation is included in the CDA.

The CDA definition in subsection 89(1) of the Act was recently amended[i] consequential on the addition of subsection 40(12) of the Act, to ensure that only the non-taxable portion of the capital gain resulting from a gift of publicly-listed securities by a private corporation, to which subsection 40(12) of the Act applies, is included in the corporation's CDA. This result is accomplished by the following amendments to the CDA definition in subsection 89(1) of the Act:

- amending clause (a)(i)(A) of the CDA definition so that the CDA is computed without reference to dispositions that are deemed to occur under subsection 40(12) of the Act, and
- adding clause (a)(i)(B.1) to the CDA definition to provide that the corporation's CDA is reduced by the amount of the taxable capital gain in respect of a deemed gain under subsection 40(12) of the Act.

In the circumstances described, where a private corporation holds publicly-listed FTS as capital property and that disposes of such FTS by way of a gift to a qualified donee, the corporation will include, in computing its CDA, the capital gain from the gift. However,

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as a result of the recent amendment to the CDA definition, the corporation will deduct, in computing its CDA, an amount equal to the taxable portion of the deemed capital gain under subsection 40(12) of the Act.

We trust these comments will be of assistance.

Yours truly,

Financial Industries Division
Income Tax Rulings Directorate
Legislative Policy and Regulatory Affairs Branch

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[1] Added by S.C. 2011, c. 24, applicable to dispositions made on or after March 22, 2011.

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