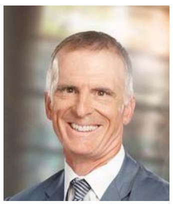
Court upholds deductibility of carrying charges

September 25, 2020

Authors



Luc Pariseau

Partner, Lawyer

Etienne C. Laplante

Lawyer

The Tax Court of Canada (the “**Court**”) recently upheld the deductibility of carrying charges incurred in connection with an issuance of shares. In so doing, the court upheld the tax benefits arising from a common financing practice.

In addition, the Court reiterated the principle in tax matters according to which, save in exceptional cases, the legal relationships established by one or more taxpayers must be respected.

In this case[1], Laurentian Bank (the “**Bank**”) issued shares from its share capital to the Caisse de dépôt et placement du Québec (“**CDPQ**”) and the Fonds de solidarité des travailleurs du Québec (“**FSTQ**”) totalling $120M, through a private placement. In addition to assuming a portion of the costs incurred by CDPQ and FSTQ in connection with this issuance of shares, the Bank agreed to pay each of the investors, as professional fees for services rendered in connection therewith, an amount corresponding to 4% of the total amount of their investment. The Canada Revenue Agency challenged the Bank’s deduction, over 5 years, of the total amount of $4.8M paid to CDPQ and FSTQ, in particular on the grounds that no services had been rendered to the Bank by the two investors and that the expense was unreasonable.

The Court ruled in favour of the Bank and allowed it to deduct the amount of $4.8M in computing its income on the basis of paragraph 20(1)(e) of the *Income Tax Act*, namely, in 20% increments over five fiscal years. Not only did the Court recognize the merits of the Bank's arguments as to the fact that it had incurred an expense for services obtained from the CDPQ and the FSTQ, but the Court also confirmed that the expense was reasonable under the circumstances.

In this decision, the Court recognized the favourable tax consequences for an issuer of shares arising from a common practice in the field of financing through share issuance. It also appears that the reasons for the Court's decision could be applied to other costs incurred in the context of financing activities and thus allow entities incurring such costs to obtain a significant tax advantage.

It is therefore to the advantage of corporations issuing shares or borrowing to carefully analyze and negotiate the financing agreements they are considering in order to maximize their tax benefits.

Our taxation team can assist you in setting up a share issuance that is both successful and optimal from a tax standpoint.

---

1. *Banque Laurentienne du Canada c. La Reine*, 2020 CCI 73