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SUBJECT 93(2), 93(2.01) - Share substituted
SECTION 93(2), 93(2.01), 248(5)(a)

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PRINCIPAL ISSUES: Whether the concept of “share substituted” used in subsection 93(2.01) may be interpreted in such a way as to refer to a chain of substitutions in which only shares are substituted?

POSITION: No.

REASONS: Interpretation and application of the ITA.

May 10, 2013

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Shares substituted and 93(2) ITA

This is in reply to your e-mail of October 4th, 2012, wherein you requested our views in respect of the application of the concept of “share substituted” referred to in subsection 93(2) of the Income Tax Act in a given hypothetical set of facts. Unless otherwise stated, all statutory references in this letter are references to the provisions of the Income Tax Act, R.S.C. 1985 (5th supp.) c. 1, as amended (“ITA”).

Background

We understand the relevant hypothetical facts to be as follows:

1. Canco owns all of the shares of **Forco1**, which qualifies as a “foreign affiliate” within the meaning assigned by the definition of this expression in subsection 95(1) (“FA”).
2. Canco **transfers Forco1’s shares to Forco2**, a second FA of Canco. In consideration, **Forco2 issues a promissory note** payable in U.S. currency (“Note”).
3. Canco **assigns the Note to Forco3**, a third FA of Canco, in exchange for shares of Forco3.

Issue

You have asked our views on whether the shares of Forco3 could be considered to be shares for which the shares of Forco1 were substituted under the meaning of this expression as it is used in the stop loss rules of paragraph 93(2)?

Comments

For the purpose of the present document, it is appropriate to note that Bill C-48 proposed that subsection 93(2) be replaced by new subsections 93(2) to 93(2.02). Those provisions would generally be applicable to losses of a corporation resident in Canada in respect of dispositions of shares that occur after February 27, 2004. Bill C-48 received second reading of the House of Commons and was referred to the Standing Committee on Finance on March 8, 2013. It was further adopted by the committee on March 26, 2013 and presented back to the House of Commons on March 27, 2013. For the purpose of the present, we are assuming that subsections 93(2) to 93(2.02) will be adopted as proposed in Bill C-48. The relevant parts of those provisions read as follow:

“(2) Application of subsection (2.01) — Subsection (2.01) applies if (a) a particular corporation (referred to in subparagraph (2.01)(b)(ii) as the "vendor", as the context requires) resident in Canada has a particular loss, determined without reference to this section, from the disposition by it at any time (referred to in subsection (2.01) as the "disposition time") of a share (referred to in subsection (2.01) as the "affiliate share") of the capital stock of a foreign affiliate of the particular corporation; or (...)”

“(2.01) Loss limitation on disposition of share of foreign affiliate — If this subsection applies, the amount of the particular loss referred to in paragraph (2)(a) or (b) is deemed to be the greater of

(a) the amount determined by the formula

$$A - (B - C)$$

Where

A is the amount of the particular loss determined without reference to this section,

B is the total of all amounts each of which is an amount received before the disposition time, in respect of an exempt dividend on the affiliate share or on a share for which the affiliate share was substituted, by

(i) the particular corporation referred to in subsection (2),

(ii) another corporation that is related to the particular corporation,

(iii) a foreign affiliate of the particular corporation, or

(iv) a foreign affiliate of another corporation that is related to the particular corporation,

and (...)”

In this situation, Canco disposes of the shares of Forco1 to Forco2 and acquires the Note in substitution therefor, and subsequently disposes of the Note to Forco3 and acquires shares of Forco3 in substitution therefor. Hence, based on the wording of subsection 93(2.01) and the application of the interpretative rule provided by paragraph 248(5)(a), we are of the view that the shares of Forco3 acquired by Canco are deemed to be substituted for the shares of Forco1.

A textual, contextual and purposive analysis of the combined application of subsection 93(2.01) and paragraph 248(5)(a) cannot in our view support an interpretation to the effect that the concept of “share substituted” refers to a chain of substitutions in which only shares are substituted. Such an interpretation does not appear to be supported by the unambiguous wording of the provisions involved. Also, in the absence of a clear indication to the contrary, we opine that it is important to strive for an interpretation of the concept of “share substituted” that is consistent throughout the ITA.

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We trust the above comments will be of some assistance.

Yours truly,

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