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Date: September 16, 2015

2014-0552711E5 Application of paragraph 251(5)(b)

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DOCNUM 2014-0552711E5

REFDATE 150707

SUBJECT Application of paragraph 251(5)(b)

SECTION 251(5)(b)

Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CRA. Prenez note que ce document, bien qu''exact au moment émis, peut ne pas représenter la position actuelle de l''ARC.

PRINCIPAL ISSUES: Does a letter of intent engage the application of paragraph 251(5)(b) of the ITA?

POSITION: General comments. No position taken.

REASONS: Question of fact and law.

XXXXXXXXXX

2014-055271

François Bordeleau

July 7, 2015

Dear XXXXXXXXXXXX:

Re: Application of paragraph 251(5)(b) of the Income Tax Act

We are writing in response to your letter received on October 27, 2014 in which you ask whether a letter of intent ("LOI") engages the application of paragraph 251(5)(b) of the Income Tax Act ("Act") .

Unless otherwise stated, every reference herein to a part, section, subsection, paragraph or a subparagraph is a reference to the relevant provision of the Act.

On December 3, 2014, you sent us a LOI which provides for the purchase of shares and real estate. In this LOI, the seller and the purchaser agree to enter into a purchase agreement following the acceptance of the LOI. The LOI also states that the parties are not bound to consummate the sale transaction and that any binding commitment will only result from the execution of a purchase agreement.

Our comments

This technical interpretation provides general comments about the provisions of the Act and related legislation (where referenced). It does not confirm the income tax treatment of a particular situation involving a specific taxpayer but is intended to assist you in making that determination. The income tax treatment of particular transactions proposed by a specific taxpayer will only be confirmed by this Directorate in the context of an advance income tax ruling request submitted in the manner set out in Information Circular IC 70-6R6, Advance Income Tax Rulings and Technical Interpretations.

Paragraph 251(5)(b) reads as follows:

(5) For the purposes of subsection (2) and the definition "Canadian-controlled private corporation" in subsection 125(7),

[...]

(b) where at any time a person has a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently,

(i) to, or to acquire, shares of the capital stock of a corporation or to control the voting rights of such shares, the person shall, except where the right is not exercisable at that time because the exercise thereof is contingent on the death, bankruptcy or permanent disability of an individual, be deemed to have the same position in relation to the control of the corporation as if the person owned the shares at that time,

(ii) to cause a corporation to redeem, acquire or cancel any shares of its capital stock owned by other shareholders of the corporation, the person shall, except where the right is not exercisable at that time because the exercise thereof is contingent on the death, bankruptcy or permanent disability of an individual, be deemed to have the same position in relation to the control of the corporation as if the shares were so redeemed, acquired or cancelled by the corporation at that time,

(iii) to, or to acquire or control, voting rights in respect of shares of the capital stock of a corporation, the person is, except where the right is not exercisable at that time because its exercise is contingent on the death, bankruptcy or permanent disability of an individual, deemed to have the same position in relation to the control of the corporation as if the

person could exercise the voting rights at that time, or

(iv) to cause the reduction of voting rights in respect of shares, owned by other shareholders, of the capital stock of a corporation, the person is, except where the right is not exercisable at that time because its exercise is contingent on the death, bankruptcy or permanent disability of an individual, deemed to have the same position in relation to the control of the corporation as if the voting rights were so reduced at that time; and

[...]

(Emphasis added)

Subsection 251(5) sets out rules that apply in deciding under subsection 251(2) whether persons are related, and in applying the definition "Canadian controlled private corporation" in subsection 125(7). Paragraph 251(5)(b) describes how a person who has any of certain rights is to be treated in determining who controls a corporation (footnote 1). These rights - which may be held under a contract, in equity or otherwise, and may be immediate or future, absolute or contingent - are described in subparagraphs 251(5)(b)(i) to (iv). Those subparagraphs also describe the consequences of holding the rights.

The courts have held on several occasions that paragraph 251(5)(b) does not operate to remove control from the person who actually controls the corporation, as the purpose of paragraph 251(5)(b) is to widen the notion of control, not restrict it.

In our view, the following conditions must be met in order for a LOI to engage the application of paragraph 251(5)(b):

* The LOI must contemplate the exercise of one of the rights provided at paragraph 251(5)(b);

* The right provided in the LOI can either be absolute or contingent and can be exercised either immediately or in the future; and

* The LOI must constitute a contract between two or more persons, in equity or otherwise.

When a LOI contemplates the exercise of one of the rights provided at paragraph 251(5)(b), the question of whether the LOI constitutes a contract, in equity or otherwise, is a question of fact and law which can only be resolved after a complete examination of all of the provisions of a particular document, letter or agreement.

It is not within the mandate of our Directorate to provide legal opinions to taxpayers with respect to contract law in the context of a technical interpretation.

Once it is established that the LOI is a contract which provides for the exercise of one of the rights at paragraph 251(5)(b), it is our view that paragraph 251(5)(b) is applicable for purposes of the definition of "Canadian-controlled private corporation" in subsection 125(7) and paragraph 251(2) at the time that the right came into existence.

We trust that the above comments are of assistance to you.

Stéphane Charette, CPA, CMA, MBA

For Director

Reorganizations Division

Income Tax Rulings Directorate

Legislative Policy and Regulatory Affairs Branch

FOOTNOTES

Note to reader: Because of our system requirements, the footnotes contained in the original document are shown below instead:

1 Department of Finance Explanatory Notes, EN December 1997 [S.C. 1998, c. 19 (Bill C-28)]