

Corporate Securities

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Recent Pronouncements on Interest Deductibility and Funds Borrowed to Acquire Common Shares

At the recent annual Canadian Tax Foundation Conference, the Canada Customs and Revenue Agency (the "CCRA") released a brief position paper on interest deductibility in a number of important commercial contexts, including the deductibility of interest on funds borrowed to acquire common shares. Under the *Income Tax Act* (Canada), interest is generally deductible in respect of funds borrowed for the purpose of gaining or producing income from a business or property. It has long been accepted, however, that interest on funds borrowed to purchase common shares of a Canadian company would be deductible notwithstanding the fact that such company may not in fact pay, or be expected to pay, dividends on its common shares.

The position paper released on October 1st (which is subject to change after a three-month consultation period) discusses the deductibility of interest on borrowed money used to acquire common shares. In this regard, the CCRA stated that an interest deduction will generally be available **unless** there is no reasonable expectation at the time the shares are acquired that dividends will be received on the common shares and that shareholders are therefore only likely to receive a profit when the shares are sold. The CCRA's preliminary views in this respect are stated as follows:

Where evidence from corporate officials indicates that dividends are not expected to be paid and that shareholders are required to sell their shares in order to realize their value, the purpose test would likely not be met. Where a corporation is silent with respect to its dividend policy, or where the dividend policy is that dividends will be paid when operational circumstances permit, the purpose test will likely be met. However, each situation must be dealt with on the basis of the particular facts involved.

Accordingly, Canadian companies should review their stated positions on dividend payments in light of this position paper. Please feel free to contact any one of the following Goodmans tax lawyers for assistance in this regard:

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