



## CRA Pronouncement Likely Puts an End to Exchangeable Debenture Financings

[Kevin Fritz](#)  
[Andrea Shreeram](#)

An announcement by representatives of the Canada Revenue Agency at the recent annual conference of the Canadian Tax Foundation likely puts an end to exchangeable debenture financings by Canadian issuers. This announcement confirmed what tax practitioners had expected following recent judicial decisions in *Imperial Oil Ltd. v. Canada* and *Tembec Inc. v. The Queen*.

A typical exchangeable debenture is an interest bearing debt instrument issued for a fixed principal amount and not at a discount. The debentures are exchangeable at the holders' option for shares of a corporation other than the issuer (the "Target") prior to maturity. The exchange ratio is fixed to a specific number of Target shares. Accordingly, if the value of the Target shares increases then the holder will receive Target shares with a value greater than the principal amount of the exchangeable debenture upon exercising the exchange right. This is to be distinguished from a convertible debenture, which refers to a debenture that can be converted into shares of the issuer itself.

Historically, the Canada Revenue Agency's administrative position has been that the issuer of the exchangeable debenture would be entitled to a deduction pursuant to paragraph 20(1)(f) of the *Income Tax Act* (Canada) for the amount by which the value of the Target shares delivered upon the exercise of exchange rights exceeded the principal amount of the debentures. This deduction would offset the gain that the issuer would realize on delivering the Target shares to debenture holders.

Paragraph 20(1)(f) provides that where a debt has been issued at a discount to its principal amount, the issuer is entitled to deduct all (in the case of a "shallow discount") or 50% (in the case

of a "deep discount") of the amount of the discount that is paid on the maturity of the debt. The *Imperial Oil* and *Tembec* decisions held, among other things, that this deduction is only available for the original issue discount as determined at the time the debt is issued.

As these two decisions can no longer be appealed to a higher court, the Canada Revenue Agency has officially stated that its administrative position regarding exchangeable debentures will not apply to any debentures issued after January 1, 2010. A debenture issued prior to this date, but modified on or after it, will be considered to have been issued on or after January 1, 2010 for these purposes.

The result of this change is that any issuer of exchangeable debentures will be subject to tax on the appreciation in value of the Target shares delivered to debenture holders on the exercise of their exchange rights with no offsetting deduction. This will likely make exchangeable debenture offerings economically unattractive to corporations seeking to raise capital through the debt markets.

*This update is intended as a summary only and should not be regarded or relied upon as advice to any specific client or regarding any specific situation.*

*If you would like further information regarding the issues discussed in this update or if you wish to discuss any aspect of this commentary, please feel free to contact us.*

### Wildeboer Dellelce LLP

Wildeboer Dellelce Place  
365 Bay Street, Suite 800  
Toronto, ON M5H 2V1  
Phone: (416) 361-3121  
Fax: (416) 361-1790

187 King Street S, Suite 205  
Waterloo, Ontario N2J 1R1  
Phone: (519) 741-8708  
Fax: (519) 741-9576

