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DOCNUM 2006-0214781E5
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DESCKEY 25
RATEKEY 2
REFDATE 080222
SUBJECT Interaction 256(9) and 110.6(2.1)
SECTION 256(9)
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Prenez note que ce document, bien qu'exact au moment émis, peut ne pas représenter la position actuelle de l'ARC.

PRINCIPAL ISSUES: In a given situation, whether or not Mr. A would be entitled to the capital gains deduction, under subsection 110.6(2.1), in respect of the disposition of the shares of the capital stock of Opco given the Federal Court of Appeal's application of subsection 256(9) in La Survivance v. HMQ, 2007 DTC 5096

POSITION: No.
REASONS: The law.

XXXXXXXXXXXX

February 22, 2008

2006-021478
Marc LeBlond
(613) 946-3261

Dear Madam:

Re: Acquisition of Control

We are writing in reply to your letter of November 9, 2006 in which you request our comments on the application of subsections 256(9) and 110.6(2.1) of the Income Tax Act in the situation described below. We apologize for the delay in replying to you.

Unless otherwise stated, all references to a statute are to the Income Tax Act (Canada), R.S.C. 1985, c.1 (5th Supp.), as amended (hereinafter the " Act ").

The Situation

- * Mr. A, a Canadian resident, owns all the shares of the capital stock of Opco.
- * Opco is a "Canadian controlled private corporation" (hereinafter "CCPC"), as defined under subsection 125(7), and the shares of Opco are "qualified small business corporation shares" (hereinafter "QSBC shares"), as defined under subsection 110.6(1), of Mr. A.
- * During a particular year, Mr. A and Pubco, a "public corporation" as defined under subsection 89(1), enter into a purchase and sale agreement in respect of all the outstanding shares of the capital stock of Opco closing on the last day of the particular year. As a result of the said purchase and sale agreement, Pubco has a right described under subparagraph 251(5)(b)(i).
- * Opco does not elect not to have subsection 256(9) apply.

Your Question and Position

You request our comments, as to whether or not, in the situation described above, Mr. A would be entitled to the capital gains deduction, under subsection 110.6(2.1), in respect of the disposition of the shares of the capital stock of Opco given the Federal Court of Appeal's (hereinafter "FCA") application of subsection 256(9) in La Survivance v. HMQ, 2007 DTC 5096.

You state that subsection 256(9) deems the control of a corporation to have been acquired at the commencement of the day on which the shares of the corporation are acquired (unless the corporation elects otherwise) and that, pursuant to subsection 249(4), the corporation will have a deemed taxation year-end immediately prior to the acquisition of control (i.e. at the end of the immediately preceding day).

In your opinion, in La Survivance, the FCA determined that parliament intended subsection 256(9) to apply to both the person acquiring control of the corporation and the person relinquishing control of the corporation. For this reason, according to you, the FCA concluded that at the first moment of the day, La Survivance (a "public corporation") was deemed to have relinquished control of its subsidiary and the purchaser (a "private corporation") was deemed to have acquired control of it. Accordingly, when La Survivance sold its shares of its subsidiary to the purchaser later that day, for the purposes of the Act, the subsidiary was controlled by the purchaser and was therefore a CCPC.

You are concerned that applying subsection 256(9) to the situation described above, as it was by the FCA in La Survivance, Mr. A would not be entitled to claim the capital gains deduction under subsection 110.6(2.1) in respect of the disposition of his shares of Opco.

In fact, the said shares would not be QSBC shares at the time of the particular day the Opco shares are sold to Pubco because Opco would not be a CCPC at that time as Mr. A is deemed to have relinquished control of Opco and Pubco is deemed to have acquired control of Opco at the commencement of that day, pursuant to subsection 256(9).

You mention that it may be possible to avoid this consequence by electing out of subsection 256(9), but in your view such an election would cause many practical difficulties in establishing a year-end cut-off part way through a particular day.

In your opinion, it is clear that the intention of parliament with respect to paragraph 110.6(14)(b) is to ensure that a Canadian resident individual disposing of shares that would otherwise be QSBC shares is not denied the capital gains deduction just because the purchaser is a public corporation or a non-resident. Accordingly, it seems to you inappropriate for subsection 256(9) to be interpreted and applied in this manner.

Our Comments

We agree with you that, in the situation you have presented, technically, Mr. A would not be entitled to the capital gains deduction, under subsection 110.6(2.1), in respect of the disposition of the shares of the capital stock of Opco on the basis of the FCA's position on subsection 256(9) in La Survivance. Therefore, unless Opco elects not to apply subsection 256(9), Mr. A would not be entitled to claim the capital gains deduction in respect of the disposition of the Opco shares.

In view of the above, we will bring this matter to the attention of the Department of Finance for consideration as to whether a legislative change is necessary.

We trust that our comments will be of assistance.

Yours truly,

Maurice Bisson, CGA
for Director
Reorganizations and Resources Division
Income Tax Rulings Directorate
Legislative Policy and Regulatory Affairs Branch