

Income Tax

IMP. 726.20.1-1 **Additional Capital Gains Exemption in respect of Certain Resource Properties**
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Reference(s): *Taxation Act* (R.S.Q., c. I-3), sections 726.20.1, 726.20.2, 726.20.3 and 726.20.4

This bulletin states the interpretation and policy of the Ministère du Revenu du Québec as concerns the additional capital gains exemption in respect of certain resource properties provided for in Title VI.5.1 of Book IV of Part I of the *Taxation Act* (the “Act”).

PRINCIPLE

1. The purpose of Title VI.5.1 of Book IV of Part I of the Act is to allow a deduction in computing the taxable income of an individual in relation to the taxable capital gain made by that individual by reason of the disposition of certain resource properties.
2. In short, this deduction is similar to that provided for in Title VI.5 of Book IV of Part I of the Act (capital gains exemption).

RESOURCE PROPERTIES

3. Under section 726.20.1 of the Act, the expression “resource property” of an individual or a partnership means capital property owned by the individual or the partnership, as the case may be, that is
 - (a) a flow-through share issued to an individual or a partnership, as the case may be, pursuant to an agreement in writing entered into during the period, hereinafter referred to as the “particular period”, commencing on May 15, 1992, and ending on December 31, 1996, as part of a public share issue, where the flow-through share was issued as part of such an issue, in respect of which the receipt for the final prospectus or the exemption from filing a prospectus was granted during the particular period;
 - (b) an interest in a particular partnership acquired by the individual or partnership, as the case may be, during the particular period as part of a public issue of interests in a partnership, where the interest in the particular partnership was acquired as part of such an issue, in respect of which the receipt for the final prospectus or the exemption from filing a prospectus was granted during the particular period, provided that

- i. a flow-through share referred to in paragraph a above is issued to the particular partnership, or
 - ii. the particular partnership incurs Canadian exploration expenses, Canadian development expenses or Canadian oil and gas property expenses after May 14, 1992; or
- (c) a property, hereinafter referred to as the “new property” substituted for another property that was a resource property of the individual under paragraph a or b above, where
- i. the new property was then acquired by the individual through a transaction in respect of which an election was made under section 518, 614 or 620 of the Act or in respect of which sections 536 to 539, 541 to 543.1 or 626 to 632 of the Act apply, on the winding-up of a Canadian corporation in respect of which sections 556 to 564.1 and 565 of the Act apply, or by reason of an amalgamation within the meaning of section 544 of the Act, and
 - ii. the individual has elected, in a letter enclosed with his fiscal return and containing, in particular, a description of the other property and the circumstances in which the new property was acquired, on or before the day on or before which the individual is required to file his fiscal return under section 1000 of the Act for the taxation year in which the substitution occurred, to consider the new property as being a resource property of the individual.

4. In short, the properties that constitute resource properties are flow-through shares or interests in a partnership that acquires such shares or incurs resource expenses. Moreover, such properties must be acquired after May 14, 1992, ordinarily in the course of a public securities issue in respect of which the receipt for the final prospectus or the exemption from filing a prospectus was granted after May 14, 1992 and before January 1, 1997. Lastly, in certain circumstances, if the individual exchanges that property for other property, the latter property may also be considered, if the individual so elects, as a resource property. That election, though, is only possible for the first substitution of the original property.

5. Under section 726.20.1 of the Act, the expression “flow-through share” has the meaning assigned by section 359.1 of the Act.

DEDUCTION

6. Section 726.20.2 of the Act provides that an individual other than a trust, in computing his taxable income for a taxation year may deduct, if he was resident in Canada throughout the year and disposed of a resource property, such amount as he may claim not exceeding the least of

- (a) the amount by which $\frac{3}{4}$ of the excess that would be referred to in paragraph a of section 726.4.10 of the Act in respect of the individual at the end of the year if the only expenses referred to in that paragraph were expenses in respect of which section 726.4.10.1 of the Act applied, exceeds the aggregate of all amounts each of which is an amount deducted under section 726.20.2 of the Act by the individual in computing the individual's taxable income for a preceding taxation year,

- (b) the aggregate of all amounts each of which is the eligible taxable capital gain amount of the individual for the year from the disposition of a resource property,
- (c) the amount that would be determined in respect of the individual for the year under paragraph *b* of section 28 of the Act in respect of capital gains and capital losses if the only properties referred to in that paragraph were resource properties,
- (d) the amount by which the amount determined in respect of the individual for the year under paragraph *b* of section 28 of the Act in respect of capital gains and capital losses exceeds the aggregate of the amount of his net capital losses sustained in other taxation years deducted under section 729 of the Act in computing his taxable income for the year and the amount that the individual deducted under Title VI.5 of Book IV of Part I of the Act (capital gains exemption) in computing his taxable income for the year.

7. The amount described in paragraph *a* of article 6 above, in particular, corresponds, in fact, to the balance of a notional account which includes the amount by which the amount of the mining, gas, or petroleum exploration expenses incurred in Québec directly or indirectly by the individual after May 14, 1992 and before January 1, 1997, exceeds the amount of assistance in relation to these expenses. Furthermore, it should be noted that every amount claimed as a deduction by the individual under section 726.20.2 of the Act for a preceding taxation year must be deducted from that notional account in order to determine its balance.

8. Furthermore, it should also be noted that paragraph *d* of article 6 above only applies from taxation year 1994 and does not correspond to the current text of section 726.20.2 of the Act. That section will be amended shortly with retroactive effect to taxation year 1994. For the taxation years before taxation year 1994, paragraph *d* of article 6 above must be replaced by paragraphs *d* and *e* of the current version of section 726.20.2 of the Act, i.e. by the following paragraphs:

- “(d) the amount by which the annual gains limit, within the meaning of subparagraph *b* of the first paragraph of section 526.6 of the Act, of the individual for the year exceeds the amount deducted under Title VI.5 of Book IV of Part I of the Act by the individual in computing the individual’s taxable income for the year, and
- (e) the amount by which the cumulative gains limit, within the meaning of subparagraph *c* of the first paragraph of section 726.6 of the Act, of the individual at the end of the year exceeds the aggregate of the amount deducted under Title VI.5 of Book IV of Part I of the Act (capital gains exemption) by the individual in computing the individual’s taxable income for the year and the amounts deducted under section 726.20.2 of the Act by the individual in computing his taxable income for the preceding taxation years.”

ELIGIBLE TAXABLE CAPITAL GAIN AMOUNT

9. Under section 726.20.1 of the Act, the expression “eligible taxable capital gain amount” of an individual for a taxation year from the disposition of a resource property, referred to in this definition as the “particular property”, means the least of

- (a) the amount by which the aggregate of all amounts each of which is the amount that may reasonably be considered to have been deducted by the individual under section 726.20.2 of the Act in computing the individual's taxable income for any preceding taxation year in respect of the disposition of the particular property is exceeded by 3/4 of:
- i. where the particular property was owned by the individual immediately before the disposition and was property referred to in paragraph a or b of the definition of "resource property" (article 3 above) in respect of the individual, the amount by which the cost to the individual of the particular property, determined without reference, where applicable, to section 419.0.1 of the Act, exceeds the adjusted cost base to the individual of the particular property immediately before the disposition,
 - ii. where the particular property was owned by the individual immediately before the disposition and was a property referred to in paragraph c of the definition of "resource property" (article 3 above) in respect of the individual that was substituted for another property that was a flow-through share or an interest in a partnership, the amount by which the cost to the individual of the other property, determined without reference, where applicable, to section 419.0.1 of the Act, exceeds the aggregate of the adjusted cost base to the individual of the other property immediately before the substitution and the capital gain, if any, of the individual from the disposition of the other property at the time of the substitution, and
 - iii. where immediately before the disposition, the particular property was owned by a particular partnership of which the individual is a member, whether directly or indirectly through another partnership, the amount that may reasonably be considered to be the individual's share of the amount by which the cost to the partnership of the particular property, determined without reference, where applicable, to section 419.0.1 of the Act, exceeds the adjusted cost base to the partnership of the particular property immediately before the disposition;
- (b) the taxable capital gain of the individual for the year from the disposition of the particular property; and
- (c) nil, where the particular property is property described in section 726.7 or 726.7.1 of the Act and the amount by which \$375 000 exceeds the aggregate of all amounts determined in respect of the individual for the year under subparagraphs i to iii of paragraph a of section 726.7 of the Act and the amount, if any, deducted under Title VI.5 of Book IV of Part I of the Act (capital gains exemption) by the individual in computing the individual's taxable income for the year, is not nil.

10. It should be noted though, that paragraph c of the definition of the expression "eligible taxable capital gain amount" described in article 9 above only applies from taxation year 1994. For taxation years before taxation year 1994, that paragraph must be read as follows:

"(c) nil, in the following cases:

- i. where the particular property is a property described in section 726.7 or 726.7.1 of the Act, the amount by which \$375 000 exceeds the aggregate of all amounts determined under subparagraphs i to iii of paragraph a of section 726.7 of the Act in respect of the individual for the year and the amount, if any, deducted under Title VI.5 of Book IV of Part I of the Act (capital gains exemption) by the individual in computing the individual's taxable income for the year, is not nil, and
- ii. where the particular property is a property described in section 726.8 of the Act, the excess described in subparagraph i and the amount by which \$75 000 exceeds the aggregate of all amounts determined under subparagraphs i to iii of paragraph a of section 726.8 of the Act in respect of the individual for the year and the amount, if any, deducted under the said section 726.8 of the Act by the individual in computing the individual's taxable income for the year are not nil (see articles 13 to 15 below for further information in this respect)."

11. From a conceptual point of view, the "eligible taxable capital gain amount" corresponds to the part of the taxable capital gain made by reason of the fact that the cost of a flow-through share is deemed to be nil (section 419.0.1 of the Act), or that the Canadian exploration expenses, the Canadian development expenses and the Canadian oil and gas property expenses incurred by a partnership reduce the adjusted cost base of the interest that a taxpayer has in that partnership (subparagraph ii of paragraph l of section 257 of the Act).

12. For example, a flow-through share acquired for \$1 000 will be deemed, in accordance with section 419.0.1 of the Act, to have been acquired at a cost equal to nil. Thus, where that share is disposed of in consideration for an amount of \$1 200, a taxable capital gain of \$900 will be made, i.e. 75% of the amount by which \$1 200 exceeds zero. The total amount though, cannot be subject to a deduction under section 726.20.2 of the Act, since such a deduction is restricted by the "eligible taxable capital gain amount" which corresponds, in such a case, to \$750, i.e. 75% of the amount by which \$1 000 exceeds zero.

13. Moreover, in accordance with paragraph c of the definition of the expression "eligible taxable capital gain amount" (article 9 above), that amount will be equal to nil if the individual has not exhausted the capital gains exemption he could otherwise have benefited from in respect of the capital gain made on the disposition of the resource property, i.e., starting with taxation year 1994, the "\$500 000" exemption and, for taxation years before taxation year 1994, the "\$100 000" or "\$500 000" exemption, as the case may be. It should be noted that this capital gains exemption may be exhausted during the same year as that for which an individual first takes advantage of the additional capital gains exemption in respect of certain resource property. Moreover, starting with taxation year 1994, the eligible taxable capital gain amount of an individual in respect of property that is not referred to in either of section 726.7 and 726.7.1 of the Act is henceforth determined without reference to the "\$100 000" capital gains exemption which the taxpayer could otherwise have taken advantage of in respect of the capital gain made at the time of disposition of that property.

14. Certain comments must be made with respect, more specifically, to subparagraph ii of paragraph c of the definition of the expression "eligible taxable capital gain amount" described in

article 10 above, which provides that the eligible taxable capital gain amount is equal to nil when the excess amounts referred to in that subparagraph ii are not amounts equal to nil. First, the amount of both excess amounts referred to in that subparagraph ii must be positive in order for the eligible taxable capital gain amount of the individual to correspond to an amount equal to nil. In other words, if only one of the excess amounts is a positive amount, the eligible taxable capital gain amount of the individual is not an amount equal to nil and he may consequently avail himself of the additional capital gains exemption in respect of certain resource properties.

15. Moreover, it should be noted that the reason for which subparagraph ii of paragraph c of the definition of the expression “eligible taxable capital gain amount” described in article 10 above refers to the excess described in subparagraph i of that paragraph c, i.e. to the available part of the “\$500 000” exemption, is that the “\$100 000” exemption of an individual may have been claimed in respect of a gain made at the time of disposition of a qualified farm property or a qualifying share of a small business corporation. Indeed, in accordance with sections 726.7 and 726.7.1 of the Act, the “\$100 000” exemption may be claimed out of the “\$500 000” exemption.

SPECIAL RULES OF APPLICATION

16. Section 726.20.3 of the Act provides that sections 726.10 to 726.13, 726.17, and 726.20 of the Act apply to Title VI.5.1 of Book IV of Part I of the Act, i.e. for the purposes of the additional capital gains exemption in respect of certain resource properties, with such modifications as the circumstances require.

17. Thus, the presumption of residence in Canada provided for in section 726.10 of the Act for immigrants or emigrants, the anti-avoidance rules provided for in sections 726.11 to 726.13 and 726.17 of the Act, as well as the rule provided for in section 726.20 of the Act for the purpose of disallowing the exemption in respect of a gain made while the individual was not resident in Canada also apply for the purposes of the additional capital gains exemption in respect of certain resource properties.

18. Moreover, section 726.20.4 of the Act provides that any reference in section 261, 270, 462.6, 517.4.2 or 517.4.4 of the Act to Title VI.5 of Book IV of Part I of the Act (capital gains exemption) or to sections 726.6 to 726.20 of the Act is deemed to include a reference to Title VI.5.1 of Book IV of Part I of the Act (additional capital gains exemption in respect of certain resource properties).

19. Thus, the rules provided for in sections 261 (negative adjusted cost base), 270 (amount disbursed in relation to a guarantee), and 462.6 of the Act (deemed gain or loss from the disposition of property) apply for the purposes of the additional capital gains exemption in respect of certain resource properties. Furthermore, for the purposes of sections 517.4.2 and 517.4.4 of the Act (non-arm’s length disposition of shares), a deduction under Title VI.5.1 of Book IV of Part I of the Act (additional capital gains exemption in respect of certain resource properties) must be taken into consideration as is the case for a deduction under Title VI.5 of Book IV of Part I of the Act (capital gains exemption).

ADMINISTRATIVE POLICY

20. As mentioned in article 6 above, an individual must have disposed of a resource property in order to take advantage of the additional capital gains exemption in respect of certain resource properties. Consequently, it is up to the individual who wishes to take advantage of the additional exemption to determine if the property he disposed of during a year constitutes or does not constitute resource property, since only resource properties give entitlement to the additional capital gains exemption in respect of certain resource properties.

21. At times, it may be impossible for an individual to determine if the property he disposed of is or is not resource property and the Ministère du Revenu recognizes such a situation.

22. For example, an individual who purchased and sold flow-through shares as described below is unable to identify the shares that were actually disposed of:

10 000 flow-through shares of X Company acquired in 1991

15 000 flow-through shares of X Company acquired in 1993

5 000 flow-through shares of X Company sold in 1994

23. In such a case, the Ministère du Revenu accepts that the taxpayer considers that the shares he first disposed of are those he acquired after May 14, 1992. Thus, provided that those shares otherwise qualify as resource property, the individual may claim an amount on account of the additional capital gains exemption in respect of certain resource properties; at any rate, the said amount will be limited to the amount of the individual's Québec exploration expenses account (see paragraph a of section 726.20.2 of the Act).

APPLICATION DATE

24. Subject to the specific application dates mentioned above, this bulletin applies from taxation year 1992.