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FINANCING FOREIGN AFFILIATES: THE TERM PREFERRED SHARE RULES AND TOWER STRUCTURES***

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Cross-border financing techniques have changed over the years as the tax laws have changed to curtail particular forms. However, one form of cross-border financing that has had a relatively long life and continues to endure is the so-called tower structure. The effectiveness of a tower structure depends on the favourable tax treatment of dividends received by an entity in the tower structure. Tax advisers might be expected to provide an opinion that such dividends are deductible pursuant to subsection 112(1) or 113(1) of the Income Tax Act. Unfortunately, if the entity in receipt of a dividend is a “specified financial institution,” in certain cases the rules in subsections 112(2.1) and 258(3) may make dividends received on “term preferred shares” non-deductible. The authors argue that shares acquired in a typical tower structure should meet the exception that is provided for dividends on shares that are not acquired in the ordinary course of a taxpayer’s business, and that this conclusion is consistent with the language, context, and purpose of the term preferred share rules. The authors examine the history and context of the term preferred share rules, the relevant tax jurisprudence, and the Canada Revenue Agency’s historical and recent administrative positions on the scope of the “not acquired in the ordinary course of business” exception.

KEYWORDS: CROSS-BORDER ■ TERM PREFERRED SHARES ■ TOWER STRUCTURES ■ ORDINARY COURSE OF BUSINESS

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