Flow-Through Shares Expansion: Policy Analysis

Flow-through shares (FTS) are a tax incentive primarily used in resource exploration sectors to attract investment by allowing companies to pass eligible expenses to investors for tax deductions. There is consideration of expanding this mechanism to other high-growth, capital-intensive sectors to stimulate economic growth and innovation.

- **Economic and Strategic Benefits:** Extending FTS could channel private capital into emerging industries like clean tech, biotech, and AI, fostering innovation, retaining Canadian investment, and supporting job creation in underdeveloped regions. It aligns with national goals for innovation and global competitiveness.
- **Fiscal and Policy Risks:** Expansion risks include increased government revenue loss, potential over-subsidization, dilution of program intent, and challenges in verifying eligibility outside traditional sectors, which could lead to abuse and inefficiencies.
- **Registered Plan Considerations and Policy Design:** FTS can be included in RRSPs with safeguards but are generally unsuitable for TFSAs due to tax inefficiencies. Any extension should define eligible sectors carefully, cap benefits to control costs, and integrate with existing incentives to avoid redundancy.

1. Background on Flow-Through Shares (FTS)

Flow-through shares are a tax mechanism allowing companies (currently almost exclusively in resource exploration like mining, oil & gas, and certain renewable energy projects) to 'flow through' eligible expenses to investors. Investors can then deduct those expenses from their own taxable income, often getting both the tax deduction and potential capital gains later when the shares are sold.

In mining, exploration companies often have high up-front expenses but no revenue in the early years. Flow-through shares make it easier to attract risk capital by giving investors immediate tax write-offs.

2. Pros of Extending Flow-Through Shares Beyond Mining

Economic Growth

- Capital Formation for High-Growth Sectors: Could channel more private capital into emerging industries like clean tech, advanced manufacturing, AI, biotech, and aerospace, boosting innovation.
- Retention of Canadian Capital: Makes Canadian investments more attractive relative to

foreign investments.
- Job Creation & Regional Development: Could stimulate local economies in rural or underdeveloped areas.

Investor Benefits

- Risk Mitigation: Tax deductions reduce the after-tax cost of investment.
- Portfolio Diversification: Gives investors a new asset class with immediate tax advantages.

Strategic Alignment

- Policy Synergy: Fits with Canada's innovation and productivity goals.
- Global Competitiveness: Could position Canada as a leader in innovation-friendly tax policy.

3. Cons / Risks of Extending Flow-Through Shares

Fiscal Cost

- Reduced Government Revenue: Expanding eligibility could significantly increase foregone tax revenue.
- Risk of Over-Subsidization: Some companies might receive capital they would have attracted anyway.

Policy Targeting Issues

- Sector Creep: Risk of diluting the program's intent.
- Moral Hazard: Incentivizing activities for eligibility rather than commercial viability.

Administrative Complexity

- Eligibility Verification: More complex outside resource exploration.
- Potential for Abuse: Need strong compliance to prevent misuse.

4. Flow-Through Shares in Registered Plans

RRSPs: Yes, FTS can be purchased in an RRSP, sometimes yielding both RRSP and FTS deductions. However, CRA has special rules to prevent abuse.
TFSAs: No, FTS are generally not purchased in a TFSA due to structural and tax efficiency reasons. The tax deduction is wasted in a TFSA since income is already tax-free.

5. Policy Implications if Extended

If Ottawa extends FTS beyond mining:
1. Define Eligible Sectors – Focus on capital-intensive, early-stage, high-innovation sectors.
2. Cap the Benefit – Limit to certain investment sizes or investor profiles to control fiscal cost.
3. Align with Registered Plans – Allow RRSP inclusion but avoid inefficient TFSA use.
4. Integrate with Existing Programs – Coordinate with other incentives to avoid redundancy.