

Optimizing Tax Strategies with Flow-Through Shares:

CEE vs. CDE for CCPCs

Introduction

For Canadian corporations, especially CCPCs, selecting the right type of flow-through shares - Canadian Exploration Expenses (CEE) versus Canadian Development Expenses (CDE) is a critical decision that can significantly impact tax planning and cash flow management.

Flow-through shares allow resource companies to transfer certain types of expenses to investors, who then claim these expenses as tax deductions.

Understanding the structural advantages between CEE and CDE flow throughs assists corporations in aligning tax strategies with their income profiles, risk tolerance, and long-term planning goals.

When CEE is More Suitable vs. CDE

CEE flow-through shares are ideal for corporations facing a **one-time taxable event** such as from asset sales or large capital gains, or those with significant passive income needing immediate tax offsets.

The **full 100% deduction in the year of investment** provides a strong upfront tax shield, helping reduce taxable income quickly.

Why CDE is Often Better for CCPCs

For CCPCs with **ongoing, recurring taxable income** such as rental income or operating profits, CDE flow-through shares often provide superior tax benefits:

- **Tax Smoothing with Declining Balance Deductions**

Rather than a large one-year deduction, CDE deductions spread over many years provide a **stable and predictable tax shield**. This mitigates large swings in taxable income and tax payable over time.

- **Long-Term Tax Efficiency**

By reinvesting annually in CDE flowthroughs, corporations can build a **deduction pool** that layers yearly deductions on top of each other. Over 3+ years, deductions can approach nearly 100% of the annual invested capital, effectively reducing current and future taxes steadily.

- **Lower Risk Profile**

CDE costs are incurred in the development and preparation phase for production, which is less risky than exploration, providing a more secure investment for conservative entities.

- Lack of ITCs for Corporates Makes CDE More Attractive**
 Since corporations generally **cannot claim Investment Tax Credits (ITCs)** that apply to some CEE investments, the long-term deduction structure of CDE flow-through shares becomes the more advantageous choice.
- Applicable to Both Active and Passive Income Corporations**
 CDE is the only flow-through option viable across different corporate income types, making it a versatile tool in tax planning.

CDE Deduction Structure in Detail

- In the **first year of investment**, a CCPC can claim around **37.5% tax deduction** on the flow-through CDE shares purchased.
- In **subsequent years**, a **30% declining balance deduction** applies to the remaining undeducted amount.
- This results in a deduction schedule that spreads the tax benefits over many years, allowing tax relief to align closely with expected future income streams.

Two Types of Flow-Through Shares: CEE vs. CDE

Cumulative CDE Deduction Schedule – Example \$100,000 annual investment 15 years

Feature	CDN Exploration Expenses (CEE)	CDN Development Expenses (CDE)
Expense Nature	Early-stage exploration (high risk)	Development/pre-production stage (lower risk)
Deduction Timing	100% deductible in the year of investment	Partial deduction: ~37.5% in year one, then 30% declining balance annually
Ideal Corporate Profile	Corporations with a one-time, large taxable event, or high passive income	Corporations with stable, recurring income seeking tax smoothing
Investment Tax Credits	Available only to individuals	No ITCs for corporations
Risk Profile	Higher risk (pure exploration)	Lower risk (development phase)

Cumulative CDE Deduction Schedule – Example \$100,000 annual investment 15 years

Year	Annual Deposit	Opening Balance	Deduction Rate	Annual Deduction	% of annual deposit	Deduction Pool Bal.
1	\$100,000	\$100,000	37.5%	\$37,500	37.5%	\$62,500
2	\$100,000	\$162,500	30.0%	\$48,750	48.8%	\$113,750
3	\$100,000	\$213,750	30.0%	\$64,125	64.1%	\$149,625
4	\$100,000	\$249,625	30.0%	\$74,888	74.9%	\$174,738
5	\$100,000	\$274,738	30.0%	\$82,421	82.4%	\$192,316
6	\$100,000	\$292,316	30.0%	\$87,695	87.7%	\$204,621
7	\$100,000	\$304,621	30.0%	\$91,386	91.4%	\$213,235
8	\$100,000	\$313,235	30.0%	\$93,970	94.0%	\$219,264
9	\$100,000	\$319,264	30.0%	\$95,779	95.8%	\$223,485
10	\$100,000	\$323,485	30.0%	\$97,046	97.0%	\$226,440
11	\$100,000	\$326,440	30.0%	\$97,932	97.9%	\$228,508
12	\$100,000	\$328,508	30.0%	\$98,552	98.6%	\$229,955
13	\$100,000	\$329,955	30.0%	\$98,987	99.0%	\$230,969
14	\$100,000	\$330,969	30.0%	\$99,291	99.3%	\$231,678
15	\$100,000	\$331,678	30.0%	\$99,503	99.5%	\$232,175
16	\$0	\$232,175	30.0%	\$69,652		\$162,522
17	\$0	\$162,522	30.0%	\$48,757		\$113,766
18	\$0	\$113,766	30.0%	\$34,130		\$79,636
19	\$0	\$79,636	30.0%	\$23,891		\$55,745
20	\$0	\$55,745	30.0%	\$16,724		\$39,022

- After 15 years of consistent annual investment, the corporation can **deduct nearly 100% of the annual investment amount in tax deductions.**
- Even after stopping investments, deductions continue on the undeducted balance for many years at 30% annually, providing ongoing tax relief.

Benefits to Corporate Tax Planning

- **Smooth Tax Liability:** CDE's multi-year deduction structure helps prevent large, unusable losses in one year, especially useful where income is steady.
- **Maximized Use of High Marginal Tax Rates:** Deductions align better with income, preserving value.
- **Capital Dividend Account (CDA) Impact:** Investments in flow-through shares increase a CCPC's CDA, allowing future tax-free capital dividends to shareholders.

- **Tax-Free Cash Flow:** Enhanced cash flow enabled by lower current taxes can be reinvested or used to repay shareholder loans.
 - **Coordination With Operating and Holding Companies:** Proper structuring between operating companies (Opco) and holding companies (Holdco) optimizes tax benefits, particularly when income exceeds small business deduction thresholds.
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Summary: Why a CCPC Should Consider CDE Flow-Through

- **Tax advantages spread over many years,** aiding in long-term planning and tax smoothing.
 - **Stable, recurring income works well with CDE's layered deductions.**
 - **Potential to approach full deduction of invested capital with multi-year investment.**
 - **Lower risk profile than exploration expenses.**
 - **Applicable to both active and passive income corporations.**
 - **Enhances after-tax returns through effective tax management.**
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Next Steps

Business owners ready to optimize their corporate tax structure using flow-through shares and CDE should consider:

- Reviewing income profiles and capital available for investment.
- Timing flow-through share purchases to maximize tax benefits before fiscal year-end.
- Coordinating with tax advisors for personalized strategic implementation.

For tailored solutions and further illustrations on CCPC-specific scenarios, a detailed consultation with tax professionals familiar with flow-through share mechanics is recommended.