Understanding Flow-Through Shares and Charity Flow-Through: Simplified

written by Tracy Hughes | September 3, 2024

I just spoke with my colleague, Peter Clausi, and after many years in the capital markets, I must say I've rarely encountered anything as inconsistently defined as flow-through shares and charity flow-throughs. As I discussed with Peter, it's clear the general market needs a straightforward explanation of these concepts. I find myself on a personal mission to define them as clearly as possible because I believe these valuable financial instruments should be accessible to everyone, not just those familiar with complex financial jargon.

So here goes…

Flow-through shares (FTS) are a unique financial instrument primarily used in Canada within the mining, oil and gas, and renewable energy sectors. They serve as a tax-based financing incentive that benefits both the companies issuing them and the investors who purchase them. While the concept might seem complex at first, understanding how flow-through shares and Charity Flow-Through work can reveal their significant advantages.

What Are Flow-Through Shares?

Flow-through shares (FTS) are designed to help resource companies raise capital for exploration and development. When a company issues these shares, it can "flow through" its tax deductions from exploration expenses to the investors who purchase the shares. This means that if you invest in flow-through shares, you can claim a tax deduction equal to the amount of your investment, effectively reducing your taxable income.

For instance, let’s say a mining company in Canada is exploring a new site. The costs associated with this exploration are typically tax-deductible. However, by issuing flow-through shares, the company can transfer these deductions to the investors. As an investor, this makes flow-through shares an attractive option because they offer a significant tax benefit while supporting crucial exploration activities.

Charity Flow-Through: Amplifying the Benefits

A Charity Flow-Through (CFT) is an innovative structure that leverages the tax benefits of flow-through shares and combines them with the advantages of charitable giving. This model creates a win-win scenario for investors, resource companies, and charitable organizations.

That said, when a company is announcing a “Charitable Flow-Through” or a “Charity Flow-Through” or a “CFT,” this is not the same as announcing a Flow-Through. Confused? Ah yes, hence this column.

Here’s how a Charity Flow-Through works: After purchasing flow-through shares, instead of holding onto them, you donate these shares to a registered charity. The charity then sells these shares to a pre-arranged buyer, typically an institutional investor, at a discount. This process ensures that the charity benefits from the donation while the investor avoids the risks associated with holding the shares.

This approach offers several key benefits:

1. **Double Tax Deductions**: As an investor, you first receive a 100% tax deduction for your initial investment in the flow-through shares. Then, because you donate the shares to a charity, you qualify for a second tax deduction on the value of your donation. This combination can significantly reduce your overall tax liability.
2. **Reduced Market and Liquidity Risk**: By donating flow-through shares to a charity, you mitigate the risks associated with share price volatility and liquidity challenges. The charity benefits from the sale of the shares, while the investor avoids holding the shares and the associated market risks.
3. **Supporting Exploration and Charitable Causes**: Charity Flow-Through allows you to support the resource exploration sector, which is vital for discovering new mineral resources, while also contributing to charitable organizations. It's a way to make your investment work harder by benefiting both economic development and social causes.

Why Are Flow-Through or Charity Flow-Through Financings Attractive?

Flow-through shares and Charity Flow-Throughs are especially appealing to high-income investors who are looking to reduce their taxable income while supporting vital industries. Companies, on the other hand, benefit from this model as it allows them to raise necessary capital for exploration and development without significantly diluting their shareholdings.

In the broader context, flow-through shares are crucial for the Canadian resource sector, enabling companies to fund exploration projects that could lead to new discoveries, particularly in areas like critical minerals, which are essential for the future of green energy technologies.

Conclusion

Flow-through shares and Charity Flow-Throughs are more than just financial instruments—they are powerful tools that drive investment in Canadian resource exploration while offering substantial tax benefits to investors. By understanding the mechanics behind these structures, investors can take full advantage of the tax benefits while supporting both the economic growth of the resource sector and the philanthropic goals of charities. This dual benefit makes flow-through shares and Charity Flow-Throughs compelling options for anyone looking to make a meaningful impact with their investments.