
Explanatory Notes Relating to the Income Tax Act, the Excise Tax Act and the Income Tax Regulations

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Preface

These explanatory notes describe proposed amendments to the *Income Tax Act*, the *Excise Tax Act* and the *Income Tax Regulations*. These explanatory notes describe these proposed amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

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These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

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Part 1
Amendments to the Income Tax Act and the Income Tax Regulations
Income Tax Act

Clause 1

Valuation of inventory – loss restriction event

ITA

10

Section 10 of the *Income Tax Act* (the “Act”) provides rules for the valuation of inventory for the purpose of computing a taxpayer’s income or loss from a business.

ITA

10(10)

Subsection 10(1.01) of the Act values inventory that is part of a taxpayer’s business that is an adventure or concern in the nature of trade at its original cost to the taxpayer. In effect, this type of inventory cannot be written down, and any accrued losses cannot be recognized, until its disposition. Subsection 10(10) sets out an exception to this general rule.

Subsection 10(10) provides that in the case of a corporation the control of which is acquired at any time, the corporation’s inventory from a business that is an adventure or concern in the nature of trade is to be valued, at the end of a corporation’s last taxation year (as determined by subsection 249(4)) before that time, at the lower of its original cost to the corporation and its fair market value at the end of that year. This allows the recognition of any accrued losses from that inventory in computing the corporation’s income for that taxation year. Subsection 10(10) also provides that after the relevant acquisition of control, the corporation’s cost of the property is that lower amount.

Subsection 10(10) is amended to extend its application to trusts. Specifically, the reference to control of a corporation being acquired is replaced with a reference to a taxpayer being subject to a loss restriction event. For further information, see the commentary on sections 251.2 and 256.

This amendment comes into force on March 21, 2013.

ITA

10(11)

Subsections 88(1.1) and 111(5) of the Act apply to restrict the carry over from one taxation year to another of certain unused non-capital or farm losses of a corporation if the corporation was subject to an intervening acquisition of control. An exception applies, allowing those losses to be carried over to be used in another year if, among other things, the relevant business is carried on for profit or with a reasonable expectation of profit throughout the other year.

For the purposes of subsections 88(1.1) and 111(5), subsection 10(11) deems a corporation’s business that is at any time an adventure or concern in the nature of trade to be a business carried on at that time by the corporation.

Subsection 10(11) is amended to extend its application to trusts, consequential on an amendment to subsection 111(5) to extend that subsection to trusts. Amended subsection 111(5) applies to a taxpayer that is a corporation or trust when the taxpayer is subject to a loss restriction event.

This amendment comes into force on March 21, 2013.

Clause 2

Income inclusions

ITA

12

Section 12 of the Act provides for the inclusion of various amounts in computing the income of a taxpayer from a business or property.

Gain – derivative forward agreement

ITA

12(1)(z.7)

New paragraph 12(1)(z.7) of the Act requires the inclusion in computing a taxpayer's income of any profit from a derivative forward agreement, which is defined in subsection 248(1). Subparagraph 12(1)(z.7)(i) applies to purchases of capital property under a derivative forward agreement. It provides that, if a taxpayer acquires a property under a derivative forward agreement in a taxation year, an amount is required to be included in computing the taxpayer's income for the year equal to the amount by which the fair market value of the property at the time it is acquired by the taxpayer exceeds the cost to the taxpayer of the property.

Subparagraph 12(1)(z.7)(ii) applies to sales of capital property under a derivative forward agreement. It provides that, if a taxpayer disposes of a property under a derivative forward agreement in a taxation year, an amount is required to be included in computing the taxpayer's income for the year equal to the amount by which the sale price of the property exceeds the fair market value of the property at the time the agreement is entered into.

A deduction is provided under paragraph 20(1)(xx) where the purchase or sale of a capital property under a derivative forward agreement results in a loss. An increase in the adjusted cost base of the capital property purchased or sold is provided under paragraphs 53(1)(s) and (t) where an amount is included in a taxpayer's income under paragraph 12(1)(z.7). Similarly, a decrease in the adjusted cost base of the capital property is provided under paragraphs 53(2)(w) and (x) where an amount is deductible under paragraph 20(1)(xx).

For further information, see the commentary on paragraphs 20(1)(xx), 53(1)(s) and (t) and 53(2)(w) and (x) and the definition "derivative forward agreement" in subsection 248(1).

Transitional Rules

Paragraph 12(1)(z.7) applies to acquisitions and dispositions of property that occur after March 20, 2013, unless transitional relief is available. Transitional relief is not available for acquisitions and dispositions of property that occur after March 21, 2018. The coming-into-force rules (i.e., the transitional rules) applicable to an acquisition or disposition of property under a derivative forward agreement depend upon whether the agreement was entered into before March 21, 2013 or after March 20, 2013.

Paragraph (3)(a) of the transitional rules applies to agreements entered into after March 20, 2013.

Paragraph (3)(b) applies to agreements entered into before March 21, 2013. Agreements entered into after March 20, 2013 will only be eligible for transitional relief if they are part of a series of derivative forward agreements and a predecessor agreement was entered into before March 21, 2013. As a result,

agreements entered into before March 21, 2013 can be extended or renewed to the end of 2014 without paragraph 12(1)(z.7) of the Act applying to acquisitions or dispositions under the agreement, provided certain conditions relating to the size of the agreement are met. These size restrictions are intended to limit new investments in an existing derivative forward agreement.

The term “notional amount” is used in respect of a derivative forward agreement in the transitional rules to describe the ‘size’ of the agreement at any particular time. More specifically, in respect of a purchase agreement, the notional amount of the agreement is the fair market value of the property that would be acquired under the agreement if the agreement were finally settled at that time. For sale agreements, the notional amount of the agreement is the sale price of the property that would be sold under the agreement if the agreement were finally settled at that time.

Transitional Rules Announced on March 21, 2013

The transitional relief provided in subparagraph (3)(a)(i) of the transitional rules reflects the coming-into-force rules that were announced on March 21, 2013. Where the more favourable transitional relief found in subparagraph (3)(a)(ii) is unavailable (e.g., because the agreement exceeded the size limits contained in the subparagraph), the transitional relief in subparagraph (3)(a)(i) may still be available. It provides transitional relief to an acquisition or disposition under a derivative forward agreement if that agreement is part of a series of agreements that includes both an agreement entered into before March 21, 2013 and an agreement entered into after March 20, 2013 and before July 11, 2013. In that case, agreements entered into before March 21, 2013 will not be taken into consideration in determining whether the series of agreements has a term in excess of 180 days. This would provide transitional relief for up to 180 days from the date the first agreement is entered into after March 20, 2013.

Source of income

ITA

12(2.02)

Economic Action Plan 2013 announced the extension of the thin capitalization rules to partnerships that operate in Canada and of which a Canadian-resident trust, or a non-resident corporation or trust, is a member. New subsection 12(2.02) of the Act provides that any amount included in computing the income of a partner for a taxation year because of paragraph 12(1)(l.1) is deemed to have the same source as the income against which the relevant interest expense is deductible at the partnership level.

The subsection ensures that any income inclusion under paragraph 12(1)(l.1) for a non-resident partner will be taxable in Canada to the same extent as income earned through the partnership. For further information, please see the commentary on subsections 18(4) and 18(7).

This amendment applies to taxation years that begin after 2013.

Clause 3

Depreciable property

ITA

13

Section 13 of the Act provides a number of rules related to the treatment of depreciable property. Generally, those rules apply for the purposes of sections 13 and 20 and the capital cost allowance regulations.

ITA

13(7)(f)

Subsection 13(7) of the Act contains rules relating to the capital cost of depreciable property.

Paragraph 13(7)(f) applies to determine the capital cost to a corporation of a property if the property is disposed of, and reacquired, by the corporation under paragraph 111(4)(e) in the circumstances of an acquisition of control of the corporation. Paragraph 111(4)(e) allows a corporation that has been subject to an acquisition of control, to elect to dispose of certain capital properties, with the resulting recognition of income or gains accrued up to the time at which control was acquired. Property designated in the election is treated as having been reacquired by the corporation at the time control was acquired. For depreciable property, paragraph 13(7)(f) applies to assign the property on reacquisition a capital cost equal to the total of the capital cost to the corporation of the property at the time of the disposition and one-half of the excess of the proceeds of disposition of the property over such capital cost.

Paragraph 13(7)(f) is amended to extend its application to trusts, consequential on an amendment to subsection 111(4) to extend the application of that subsection to trusts. Amended subsection 111(4) applies to a taxpayer that is a corporation or trust when the taxpayer is subject to a loss restriction event. For further information, see the commentary on sections 111 and 251.2.

This amendment comes into force on March 21, 2013.

ITA

13(21.2)

Subsection 13(21.2) of the Act defers, in certain circumstances, the realization of a loss that would otherwise arise from the disposition by a person or partnership (the transferor) of a depreciable property. The subsection applies if the transferor or an affiliated person holds the disposed property, or has a right to acquire it, 30 days after the disposition. Until the earliest of certain so-called “release events” described in subparagraph 13(21.2)(e)(iii) occurs, the transferor is treated as holding a notional depreciable property the capital cost of which is, in effect, the amount of the deferred loss.

One such release event, described in clause 13(21.2)(e)(iii)(D), is the acquisition of control of a corporation. The corporation is treated as no longer holding notional depreciable property as of the time that is immediately before the time that is immediately before control is acquired. The result is that the suspended terminal loss is recognized by the corporation in its last taxation year (as determined by subsection 249(4)) before its acquisition of control.

Clause 13(21.2)(e)(iii)(D) is amended to extend its application to trusts, by referring to a transferor that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

ITA

13(24) and (25)

Subsection 13(24) applies if a corporation, or a partnership of which a corporation is a majority-interest partner, acquires a depreciable property (subject to an exception for property transferred among affiliated persons including the corporation or partnership) within the 12-month period that ends immediately before an acquisition of control of the corporation. If the property was not used, or acquired for use, in a business carried on by the corporation immediately before that period, two rules

apply. First, if the property was disposed of and not reacquired before the acquisition of control, the property is treated for capital cost allowance purposes as having been acquired immediately before the disposition. If the first rule does not apply, for purposes of the investment tax credit rules in section 127, the refundable investment tax credit rules in sections 127.1 and the computation of undepreciated capital cost, the property is treated as not having been acquired until after the acquisition of control.

Subsection 13(24) is amended to extend its application to trusts. Specifically, the subsection applies if a taxpayer that is a corporation or trust, a partnership of which the taxpayer is a majority-interest partner or, on or after Announcement Date, a trust of which the taxpayer is a majority-interest beneficiary, acquires a depreciable property within the 12-month period that ends immediately before the taxpayer is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

If a taxpayer referred to in subsection 13(24) is formed shortly before it became subject to a loss restriction event, the exception provided in that subsection for transfers among affiliated persons will not apply. Specifically, the acquired property will not be able to meet the test of having been held by the taxpayer or by an affiliated person throughout the relevant period. Subsection 13(25) ensures the appropriate result under subsection 13(24) in such a case. Subsection 13(25) treats a newly-formed corporation or trust as having been in existence from the time immediately before the relevant 12-month period to the time immediately after it was formed, and as having been affiliated during that time with the persons with whom it was affiliated from its formation until it is subject to a loss restriction event.

Subsection 13(25) is amended to extend its application to trusts, consequential on the extension of subsection 13(24) to trusts. The references in subsection 13(25) to “incorporated or otherwise formed” have been changed to “formed or created” to account for trusts. This amendment comes into force on March 21, 2013.

Clause 4

Eligible capital property

ITA

14

Section 14 of the Act provides rules concerning the tax treatment of expenditures and receipts of a taxpayer in respect of “eligible capital property”.

ITA

14(12)(f)

Subsection 14(12) of the Act applies if a corporation, trust or partnership (the transferor) disposes of eligible capital property in respect of a business and would, in the absence of the subsection, be entitled as a consequence of the disposition to claim a deduction under subsection 24(1) for any undeducted amounts remaining in its cumulative eligible capital pool in respect of the business. If the transferor or an affiliated person acquires the property (or an identical property) during the period that begins 30 days before the disposition and ends 30 days after the disposition and the transferor or an affiliated person owns the property at the end of that period, the transferor is treated as owning eligible capital property in respect of the business and not to have ceased carrying on the business until the earliest of certain so-called “release events” described in paragraphs 14(12)(c) to (g).

One such release event, as described in paragraph 14(12)(f), is, if the transferor is a corporation, the acquisition of control of the transferor. Paragraph 14(12)(f) is amended, to extend its application to trusts, by referring to a transferor that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

Clauses 5 and 6

Interest – certain bonds

ITA

15.1 and 15.2

Sections 15.1 and 15.2 of the Act set out rules defining and governing the treatment of small business development bonds and small business bonds. Interest payable on these bonds is not deductible to the issuer and is treated as a taxable dividend to the recipient.

The references in sections 15.1 and 15.2 to the term “majority interest partner” are replaced with references to “majority-interest partner”. These amendments are consequential on a similar amendment to the definition “majority-interest partner” in subsection 248(1). For further information, see the commentary on that definition.

These amendments come into force on Royal Assent.

Clause 7

Prohibited deductions

ITA

18

Section 18 of the Act lists deductions that are prohibited in computing a taxpayer’s income from a business or property.

Limitation – deduction of interest by certain entities

ITA

18(4)

The thin capitalization rules in subsections 18(4) to 18(8) of the Act prevent a corporation resident in Canada from deducting interest on debts owing to certain specified non-residents to the extent that the debts owing to such non-residents exceed a 1.5-to-1 debt-to-equity ratio. Economic Action Plan 2013 announced the extension of the scope of application of the thin capitalizations rules to Canadian-resident trusts and to non-resident corporations and trusts. Non-resident corporations and trusts that file a tax return under Part I of the Act in accordance with section 216 will be subject to the thin capitalization rules as they apply to non-residents.

Subsection 18(4) of the Act is amended to extend the scope of application of the thin capitalization rules to Canadian-resident trusts and to non-resident corporations and trusts that operate in Canada, whether directly or as members of a partnership. The thin capitalization rules do not apply to a Canadian banking business of an authorized foreign bank (these businesses are addressed in section 20.2).

Subsection 18(4) is also amended to replace the description of a corporation’s equity for the purposes of the thin capitalization rules in clauses 18(4)(a)(ii)(A) to (C) with the new defined term “equity

amount”. This definition incorporates the current description of a corporation’s equity for thin capitalization purposes along with defining the ‘equity’ of Canadian-resident trusts and non-resident corporations and trusts. For further information, please see the commentary on the definition of “equity amount” in subsection 18(5).

These amendments apply to taxation years that begin after 2013.

Definitions

ITA

18(5)

Subsection 18(5) of the Act is amended in two ways. First, the definition “outstanding debts to specified non-residents” is amended to reflect the extension of the thin capitalization rules to Canadian-resident trusts and to non-resident corporations and trusts. Second, the following definitions are introduced: “beneficiary”, “equity amount”, “equity contribution”, “specified beneficiary”, “specified non-resident beneficiary” and “tax-paid earnings”.

“outstanding debts to specified non-residents”

The application of the thin capitalization rules to a debt depends on whether the debt is included in a taxpayer’s “outstanding debts to specified non-residents”. Paragraph (a) of the definition “outstanding debts to specified non-residents” is amended to extend the current definition to address debts of a trust by adding references to trust and to specified non-resident beneficiary of a trust. Specified non-resident beneficiary is defined in subsection 18(5).

This amendment applies to taxation years that begin after 2013.

“beneficiary”

Subsection 18(5) of the Act is amended to add the definition “beneficiary”. For the purposes of the thin capitalization rules in subsections 18(4) to (6), a beneficiary of a trust has the same meaning as in subsection 108(1).

This amendment applies to taxation years that begin after 2013.

“equity amount”

Subsection 18(5) of the Act is amended to add the definition “equity amount”. Paragraph (a) of the definition contains the description of a Canadian-resident corporation’s equity previously found in clauses 18(4)(a)(ii)(A) to (C). Paragraph (b) contains the description of a Canadian-resident trust’s ‘equity’ and paragraph (c) contains a description of a non-resident corporation or trust’s ‘equity’ for thin capitalization purposes.

Paragraph (b) of the definition “equity amount” – Trusts resident in Canada

The equity amount of a trust, resident in Canada, for a taxation year is computed by determining the amount by which the total of:

- the average amount of all equity contributions made by specified non-resident beneficiaries to the trust before the beginning of each month in the year, and
- the tax-paid earnings of the trust for the year,

exceeds

- the average amount of all distributions made the trust to its specified non-resident beneficiaries before the beginning of each month in the year (except if such amounts are included in the beneficiary's income because of subsection 104(13) or from which tax was deducted under Part XIII because of paragraph 212(1)(c)).

As with the rules for Canadian-resident corporations in paragraph (a) of the definition, this computation effectively provides that a Canadian-resident trust's equity amount is determined by reference to the capital contributions from specified non-residents less returns of capital to specified non-residents plus retained earnings.

An election is available for a trust to compute its equity as at March 21, 2013 based on the amount of its assets less the amount of its liabilities. Although this election is available to all Canadian-resident trusts, it is intended to assist trusts that have insufficient historical information available to determine their equity amounts on March 21, 2013. A trust must elect in writing and file the election with the Minister of National Revenue on or before its filing-due date for its first taxation year that begins after 2013.

If the election is made, for the purpose of determining the trust's equity amount, the trust is deemed: not to have received any equity contributions (as defined in subsection 18(5)) before March 21, 2013; not to have paid or made payable any amount to a beneficiary of the trust before March 21, 2013; and to have tax-paid earnings (as defined in subsection 18(5)) of nil for each taxation year that ends before March 21, 2013.

As well, the election determines the trust's equity amount based on the value of its assets less the amounts of its liabilities on March 21, 2013. Each beneficiary of the trust at the start of March 21, 2013 is deemed to have made an equity contribution at that time to the trust equal to the amount determined by the formula: $A/B \times (C - D)$. A/B provides the beneficiary's proportionate interest in the trust, based on the relative fair market value of the beneficiary's interest in the trust. Variable C is the fair market value of all the properties of the trust at the start of March 21, 2013 and variable D is the total amount of the trust's liabilities at that time.

Paragraph (c) of the definition "equity amount" – Corporations and trusts not resident in Canada

Since a Canadian branch of a non-resident corporation or trust is not a separate legal person from the non-resident entity, it does not have equity as determined for thin capitalization purposes. Therefore, a 3-to-5 (or 60%) debt-to-assets ratio is used to provide a notional amount of equity against which the debts of the non-resident entity are tested, which parallels the 1.5-to-1 debt-to-equity ratio used for Canadian-resident corporations. The debt-to-assets ratio is based on the cost of the assets used or held by the non-resident entity in respect of its Canadian activities.

Based on the 3-to-5 debt-to-assets ratio, the permitted equity amount threshold for a non-resident corporation or trust, for thin capitalization purposes, is generally computed as being 40% of the cost, on an averaged basis, of the assets or property used or held by the non-resident corporation or trust in respect of its Canadian activities less the outstanding debts of the non-resident entity that relate to its Canadian activities and that are not included in its outstanding debts to specified non-residents.

This amendment applies to taxation years that begin after 2013.

Example – Canadian branch of a non-resident corporation

NRFinco and NROpco are wholly-owned subsidiaries of NRParent, all of which are corporations and none of which are resident in Canada. NROpco carries on a business in Canada through a branch. The properties of NROpco used in its Canadian branch have a total cost of \$350,000. NRFinco has made a loan of \$150,000 to NROpco, the proceeds of which are used by NROpco in its Canadian business. An arm's length financial institution has made a loan of \$100,000 to NROpco, the proceeds of which are also used by NROpco in its Canadian business.

NROpco's equity amount would equal 40% of the amount, if any, by which the total cost of the Canadian branch's assets (\$350,000) exceeds the amount of its debts used in the Canadian branch that are not owing to specified non-residents (\$100,000). This is multiplied by 1.5 to arrive at NROpco's thin capitalization limit. The limit is $1.5 \times 40\% (\$350,000 - \$100,000) = \$150,000$. NROpco would therefore be entitled to deduct interest on up to \$150,000 of non-arm's length debts. This corresponds to a 3-to-5 (or 60%) debt-to-assets ratio.

“equity contribution”

Subsection 18(5) of the Act is amended to add the definition “equity contribution”. An equity contribution to a trust is a transfer of property to the trust made in exchange for an interest as a beneficiary under the trust, or a right to acquire such an interest, or for no consideration by a person beneficially interested in the trust.

This amendment applies to taxation years that begin after 2013.

“specified beneficiary”

Subsection 18(5) of the Act is amended to add the definition “specified beneficiary”. This definition is based on the existing “specified shareholder” definition in subsection 248(1). It provides that a person (either alone or together with persons with whom that person does not deal at arm's length) who owns 25% or more of the fair market value of all interests as a beneficiary under a trust is a specified beneficiary of that trust.

For the purpose of determining whether a particular person has met the 25% threshold, that person's rights (and those of non-arm's length persons) to acquire beneficial interests are deemed to have been exercised. Any beneficial interests, other than beneficial interests held by the person, that the person (or a non-arm's length person) has the right to require a trust to redeem, acquire or terminate will be considered to have been so redeemed, acquired or terminated. This does not apply if the exercise of the right is contingent on the death, bankruptcy or permanent disability of an individual. Where a particular person has a discretionary interest in a trust, the person's maximum possible interest in the trust will be used in determining whether the 25% threshold has been met.

This amendment applies to taxation years that begin after 2013.

“specified non-resident beneficiary”

Subsection 18(5) of the Act is amended to add the definition “specified non-resident beneficiary”. This definition is the corollary of the existing definition “specified non-resident shareholder” in subsection 18(5), which applies in the corporate context.

This amendment applies to taxation years that begin after 2013.

“tax-paid earnings”

Subsection 18(5) of the Act is amended to add the definition “tax-paid earnings”. The determination of a Canadian-resident trust’s equity amount (defined in subsection 18(5)) requires the computation of the tax-paid earnings of the trust for each of its taxation years. The tax-paid earnings of a trust resident in Canada for a taxation year are its taxable income under Part I of the Act for that year less the combined federal and provincial tax paid on that income for the particular year.

This amendment applies to taxation years that begin after 2013.

Specified shareholder or specified beneficiary

ITA

18(5.1)

Subsection 18(5.1) of the Act ensures that a person who would otherwise be a specified shareholder of a corporation will not be treated as such if the person becomes a specified shareholder in order to safeguard the person’s rights in respect of indebtedness outstanding and owing to the person or a non-arm’s length person, and it is reasonable to conclude that a condition or event contemplated in an agreement in effect at the time the provision is being applied will occur to cause the person no longer to be a specified shareholder.

Subsection 18(5.1) is amended to extend the current rule to apply in the trust context by adding references to a specified beneficiary of a trust (specified beneficiary is defined in subsection 18(5)).

This amendment applies to taxation years that begin after 2013.

Deemed specified shareholder or specified beneficiary

ITA

18(5.2)

Economic Action Plan 2013 announced the extension of the thin capitalization rules to non-resident corporations and trusts that carry on business in Canada, or that, in accordance with section 216 of the Act, are taxable in Canada under Part I (rather than Part XIII) of the Act on certain income. The Canadian operations of these non-resident corporations and trusts are effectively treated in the same way as if they were carried out through a wholly-owned subsidiary. However, a Canadian branch is not a separate legal person from the non-resident corporation or trust that it is a part of and as a consequence, a Canadian branch does not have specified shareholders and a non-resident cannot make a loan directly to it.

Therefore, for the purpose of applying the thin capitalization rules to non-resident corporations and trusts, new subsection 18(5.2) is added to deem a non-resident corporation to be a specified shareholder of itself and a non-resident trust to be a specified beneficiary of itself. The effect of this deeming rule and clause (a)(i)(B) of the definition “outstanding debts to specified non-residents” in subsection 18(5) is that a loan to a non-resident corporation or trust from a non-resident person who does not deal at arm’s length with the non-resident corporation or trust will be included in outstanding debts to specified non-residents for the non-resident corporation or trust. This result is consistent with that where a loan is made to a Canadian subsidiary from a non-resident person that does not deal at arm’s length with the foreign parent of the Canadian subsidiary.

This amendment applies to taxation years that begin after 2013.

Property used in business – cost attribution

ITA

18(5.3)

Economic Action Plan 2013 announced the extension of the thin capitalization rules to non-resident corporations and trusts that operate in Canada, whether directly or as members of a partnership. Non-resident corporations and trusts that operate in Canada through a branch are effectively treated in the same way as if the Canadian branch were a wholly-owned subsidiary of the non-resident. Since a branch does not have equity in the same sense as a wholly-owned subsidiary, a 3-to-5 debt-to-assets ratio is used for Canadian branches for thin capitalization purposes. The asset portion of this debt-to-assets ratio uses the cost of the property used or held by the non-resident entity in respect of its Canadian activities. As well, amended paragraph 18(7)(a) of the Act allocates to a non-resident partner its share of the property of the partnership, which is included with the non-resident's properties for the purpose of determining the non-resident's equity amount (as defined in subsection 18(5)). For further information, please see the commentary on subsections 18(4), (5) and (7).

Subsection 18(5.3) is introduced to provide rules that determine, in certain circumstances and for the purpose of determining the non-resident's equity amount, what the cost and use of a particular property is in relation to the Canadian activities of a non-resident corporation or trust. Paragraph 18(5.3)(a) provides a deeming rule that determines the cost of a property for thin capitalization purposes if the property is only partly used in Canada. This cost is based on the proportionate use of property in Canada compared to its total use. Subparagraphs 18(5.3)(b)(i) and (ii) deal with partnerships. They allow the thin capitalization rules to apply in respect of property held by a partnership in which a non-resident corporation or trust is a member in the same way the rules would apply if the partner's share of the property were held directly. Subparagraph 18(5.3)(b)(i) allocates the cost of properties of a partnership to its partners in the same proportion as the debts of the partnership are allocated. Subparagraph 18(5.3)(b)(ii) deems the property to be used or held by the partner in the course of carrying on business in Canada if the partnership used or held it in the course of carrying on business in Canada.

This amendment applies to taxation years that begin after 2013.

Rules – trust income

ITA

18(5.4)

In general terms, income earned by a trust can either be taxed in the trust or be paid or made payable to beneficiaries of the trust, in which case the trust is provided with a deduction and the income is taxable to the beneficiaries. Subsection 18(5.4) of the Act is introduced to allow the same results with respect to the additional income of a trust that arises as a consequence of the application of the thin capitalization rules, whether due to the denial of interest expense under subsection 18(4) or an income inclusion under paragraph 12(1)(l.1).

Under subsection 18(5.4), a trust may elect that all or a portion of an amount that is paid or credited as interest by the trust, or a partnership in which the trust is a member, to a non-resident person be deemed to be income of the trust that has been paid to the non-resident person as a beneficiary of the trust. This election is available if the amount is not deductible in computing the trust's income because of subsection 18(4) or is included in computing the income of the trust under paragraph 12(1)(l.1). The

amount would consequently be subject to non-resident withholding tax under Part XIII of the Act (and potentially to tax under Part XII.2).

This amendment applies to taxation years that begin after 2013.

Loan made on condition

ITA

18(6)

Subsection 18(6) of the Act is designed to ensure that the disallowance of interest expense under subsection 18(4) cannot be circumvented by a lending arrangement in which a specified non-resident shareholder of a corporation, instead of making a loan directly, makes it through an intermediary – for example, by lending funds to another person on condition that the other person make a loan to the corporation.

Subsection 18(6) is amended to extend the application of the provision to the trust context by adding references to a specified non-resident beneficiary (as defined in subsection 18(5)) of a trust. Specified non-resident beneficiary is the corollary of specified non-resident shareholder, which applies in the corporate context and is also defined in subsection 18(5).

This amendment applies to taxation years that begin after 2013.

Partnership debts

ITA

18(7)

Subsection 18(7) of the Act provides that, for the purposes of the thin capitalization rules, a partner's share of the debts of a partnership is included with the partner's directly owed debts in determining whether it has exceeded the debt-to-equity threshold under the thin capitalization rules.

The equity component of a non-resident corporation or trust's debt-to-equity ratio for thin capitalization purposes is determined in the new definition "equity amount" in subsection 18(5). A non-resident's equity amount is based in part on the non-resident's cost of its property that is used or held in its Canadian activities.

Paragraph 18(7)(a) is amended to allocate to a non-resident partner its share of the property (in addition to allocating its share of the debts) of the partnership for purposes of determining the partner's equity amount. More specifically, each member of a partnership is deemed to own a portion of each property of the partnership based on the partner's proportionate interest in the partnership.

This amendment applies to taxation years that begin after 2013.

ITA

18(15)(b)(iii)

Subsections 18(13) to (15) of the Act contain a loss suspension rule that applies to property disposed of by a taxpayer (the transferor) that is a money lender. Subsections 18(13) and (14), respectively, set out the conditions under which the relevant losses are suspended. Subsection 18(15) describes the loss suspension itself. The relevant loss is suspended until the earliest of certain so-called "release events" described in subparagraphs 18(15)(b)(i) to (iv). One such release event, described in subparagraph 18(15)(b)(iii), is, if the transferor is a corporation, the acquisition of control of the transferor.

Subparagraph 18(15)(b)(iii) is amended to extend its application to trusts, by referring to a transferor that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

Clause 8

Matchable expenditure

ITA

18.1

Section 18.1 of the Act restricts the deductibility of an otherwise deductible “matchable expenditure” incurred in respect of a “right to receive production” by prorating the deductibility of the amount of the expenditure over the economic life of the right.

ITA

18.1(10)(b)(ii)

Subsection 18.1(7) of the Act allows taxpayers to claim a terminal deduction upon the disposition or expiry of the right to which a matchable expenditure relates. Subsection 18.1(7) is, however, subject to the rules in subsections 18.1(8) to (10), which apply to a disposition or expiry of such a right where within a certain period of time an affiliated or non-arm’s length person holds the property or identical property. In these circumstances, the terminal deduction is restricted until the earliest of certain so-called “release events” described in subparagraphs 18.1(10)(b)(i) to (v). One such release event, described in subparagraph 18.1(10)(b)(ii), is, if the taxpayer is a corporation, the acquisition of control of the taxpayer.

Subparagraph 18.1(10)(b)(ii) is amended to extend its application to trusts, by referring to a taxpayer that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

Clause 9

Deductions

ITA

20

Section 20 of the Act provides rules relating to the deductibility of certain outlays, expenses, and other amounts in computing a taxpayer’s income for a taxation year from business or property.

Premiums on life insurance used as collateral

ITA

20(1)(e.2)

Paragraph 20(1)(e.2) of the Act permits a limited deduction in respect of life insurance premiums under a life insurance policy where an interest in the policy has been assigned as collateral for a loan and certain other conditions are met. The amount deductible by a taxpayer may not exceed a specified portion of the lesser of the premiums payable by the taxpayer under the policy in respect of the year and the net cost of pure insurance (as determined in accordance with section 308 of the *Income Tax Regulations*) in respect of the interest in the policy for the same year. The specified portion is the

portion of the lesser of the two amounts that can reasonably be considered to relate to the amount owing from time to time during the year by the taxpayer under the loan.

Paragraph 20(1)(e.2) is amended so that amounts are not deductible under paragraph 20(1)(e.2) in respect of an LIA policy. Specifically, the preamble of paragraph 20(1)(e.2) is amended so that no amount is deductible in respect of a LIA policy or an annuity contract. For further information on LIA policies, see the commentary on the definition “LIA policy” in subsection 248(1).

Paragraph 20(1)(e.2) is also amended so that no amount will be deductible in respect of a 10/8 policy under that paragraph in respect of a period after 2013. In particular, the amount determined under amended subparagraph 20(1)(e.2)(ii) in respect of a 10/8 policy ignores, in computing the net cost of pure insurance for the relevant year in respect of the policy, the portion of that net cost in respect of insurance provided during a period after 2013 during which the policy is a 10/8 policy. For further information on 10/8 policies, see the commentary on the definition “10/8 policy” in subsection 248(1).

Finally, paragraph 20(1)(e.2) is restructured by moving the existing postamble of the paragraph into a new subparagraph 20(1)(e.2)(iii).

These amendments apply to taxation years that end after March 20, 2013.

Loss – derivative forward agreement

ITA

20(1)(xx)

New paragraph 20(1)(xx) of the Act provides a deduction in computing a taxpayer’s income of a loss from a derivative forward agreement, which is defined in subsection 248(1). The amount of the deduction that is available in a particular year is determined by the formula $A - B$.

Variable A is the lesser of subparagraphs (i) and (ii). Subparagraph (i) represents the accumulated losses under the derivative forward agreement. Subparagraph (ii) limits deductions in respect of partial (i.e., not final) settlements of a derivative forward agreement to the amount of income that has been included in respect of the agreement.

Subparagraph (i) of variable A provides the cumulative total of losses under the agreement. Clause (i)(A) applies to purchases and clause (i)(B) applies to sales. For clause (i)(A), the amount is determined as the amount by which the cost to the taxpayer of the property exceeds the fair market value of the property at the time it is acquired by the taxpayer. For clause (i)(B), the amount is determined as the amount by which the fair market value of the property at the time the agreement is entered into exceeds the sale price of the property.

Subparagraph (ii) of variable A generally provides that, until final settlement of a derivative forward agreement occurs, the total amount of deductions available in respect of the derivative forward agreement is limited to the total of all amounts included under paragraph 12(1)(z.7) in computing the taxpayer’s income in respect of the derivative forward agreement. On final settlement of the agreement, the limitation continues to apply if one of the main reasons for entering into the agreement is to obtain a deduction under paragraph 20(1)(xx). This provision allows deductions where a loss arises as the consequence of a negative return on a *bona fide* investment and prevents the use of schemes designed, even in part, to obtain the benefit of the deduction.

Variable B of the formula in paragraph 20(1)(xx) ensures that amounts are deductible only once under paragraph 20(1)(xx).

A decrease in the adjusted cost base of the capital property purchased or sold is provided in paragraphs 53(2)(w) and (x) where an amount is deductible under paragraph 20(1)(xx). Similarly, an increase in the adjusted cost base of the capital property is provided in paragraphs 53(1)(s) and (t) where an amount is included in a taxpayer's income because of paragraph 12(1)(z.7).

For further information, see the commentary on paragraphs 12(1)(z.7), 53(1)(s) and (t) and 53(2)(w) and (x) and the definition "derivative forward agreement" in subsection 248(1).

Paragraph 20(1)(xx) applies to acquisitions and dispositions of property that occur after March 20, 2013, unless transitional relief is available. For further information, see the commentary on paragraph 12(1)(z.7).

Limitation of expression "interest" – 10/8 policies

ITA

20(2.01)

New subsection 20(2.01) of the Act has the effect of denying an interest deduction under paragraphs 20(1)(c) and (d) in respect of amounts paid or payable under a borrowing or policy loan that relates to a 10/8 policy. If the amount is paid or payable after March 20, 2013 in respect of a period after 2013 during which a policy is a 10/8 policy, the amount is deemed not to be interest for the purposes of those paragraphs.

For further information on 10/8 policies, see the commentary on the definition "10/8 policy" in subsection 248(1).

This amendment applies to taxation years that end after March 20, 2013.

Clause 10

Private health services plan

ITA

20.01

Section 20.01 of the Act permits an individual to deduct, in computing the individual's income from a business carried on by the individual and in which the individual is actively engaged on a regular and continuous basis (directly or as a member of a partnership), amounts payable under a private health services plan (PHSP) for the benefit of the individual, the individual's spouse or common-law partner and members of the individual's household.

ITA

20.01(2)(b)(i)(A)(II)

The reference in the English version of subclause 20.01(2)(b)(i)(A)(II) of the Act to the term "majority interest partner" is replaced with a reference to "majority-interest partner". This amendment is consequential on a similar amendment to the definition "majority-interest partner" in subsection 248(1). For further information, see the commentary on that definition.

This amendment comes into force on Royal Assent.

Clause 11

Restricted farm loss

ITA

31(1)

Subsection 31(1) of the Act restricts the farming losses deductible by a taxpayer against income from other sources in a taxation year unless the taxpayer's chief source of income for the year is farming or a combination of farming and some other source of income. This restriction ensures that taxpayers for whom farming is not the principal occupation are limited in their ability to deduct from their non-farm income losses from farming. Farming losses are computed in accordance with favourable farm tax rules which could include the cash method of accounting under section 28.

The unrestricted portion of such farm losses is limited to \$2,500 plus $\frac{1}{2}$ of the next \$12,500 of losses. The remainder of such a loss is defined, for the purposes of the Act, as a "restricted farm loss". A restricted farm loss for a taxation year is deductible under paragraph 111(1)(c) in computing taxable income for the three preceding taxation years or the 20 following taxation years to the extent of the taxpayer's income from farming in those years.

Subsection 31(1) is amended to codify the interpretation of subsection 31(1) set out in the Supreme Court of Canada's decision in *Moldowan v. The Queen*, [1978] 1 SCR 480. Specifically, the amendment clarifies that a taxpayer will be limited to the deduction in respect of farm losses set out in subsection 31(1) if the taxpayer does not look to farming, or to farming and some subordinate source of income, for their livelihood. This amendment replaces the interpretation placed on section 31 by the Supreme Court of Canada in its decision in *The Queen v. Craig*, 2012 SCC 43, and applies to taxation years that end after March 20, 2013.

In addition, subparagraphs 31(1)(a)(i) and (b)(i) of the Act are amended to delete their reference to section 37.1, which has been repealed. The amendments to subparagraphs 31(1)(a)(i) and (b)(i) apply to taxation years that end after March 20, 2013.

Finally, for taxation years that end after March 20, 2013, clause 31(1)(a)(ii)(B) is amended to increase the unrestricted portion of losses from farming for a taxpayer that is limited by section 31(1) to \$2,500 plus $\frac{1}{2}$ of the next \$30,000 of losses.

Farming and manufacturing or processing

ITA

31(2)

Existing subsection 31(2) of the Act provides that the Minister of National Revenue may determine that a taxpayer's chief source of income for a year is neither farming nor a combination of farming and some other source. Existing subsection 31(2) is repealed and replaced by a new provision.

New subsection 31(2) sets out the circumstances under which subsection 31(1) will not apply to a taxpayer. In particular, subsection 31(2) provides that the restrictions on farm losses in subsection 31(1) will not apply where the taxpayer's chief source of income is a combination of farming and manufacturing or processing in Canada of goods for sale, and all or substantially all of the output from all of the taxpayer's farming businesses is used in the manufacturing or processing. Subsection 31(2) is relevant in cases where the taxpayer's chief source of income is farming and manufacturing or processing, but manufacturing and processing is not subordinate to the taxpayer's farming source of income.

Subsection 31(2) applies to taxation years that end after March 20, 2013.

Clause 12

Scientific research and experimental development

ITA

37

Section 37 of the Act contains rules for the deductibility of expenditures incurred by a taxpayer for scientific research and experimental development (SR&ED).

ITA

37(1)(h) and 37(6.1)

Subsection 37(1) of the Act permits a taxpayer carrying on business in Canada in a taxation year to deduct, in computing the taxpayer's income from a business for the year, certain current and capital expenditures incurred in respect of SR&ED carried on in Canada. The maximum amount deductible for a year, which is accumulated in a pool, is computed under paragraphs 37(1)(a) to (h). Under paragraph 37(1)(h), if the taxpayer is a corporation the control of which is acquired before the end of the year, the pool is reduced by the amount determined for the year under subsection 37(6.1) with respect to the taxpayer. The effect of these rules is to restrict the ability of a corporation, that is subject to an acquisition of control, to carry forward to the current year expenditures incurred in a year prior to the acquisition of control. In general terms, the undeducted SR&ED expenditures from before the acquisition of control may be carried forward for use in the current year only if the business to which the expenditures relate is carried on throughout the current year by the corporation for profit or a reasonable expectation of profit and only to the extent of its income for the current year.

Paragraph 37(1)(h) and subsection 37(6.1) are amended to extend their application to trusts, by referring to a taxpayer that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

These amendments come into force on March 21, 2013.

ITA

37(9.5)(b)

The reference in the English version of paragraph 37(9.5)(b) of the Act to the term "majority interest partner" is replaced with a reference to "majority-interest partner". This amendment is consequential on a similar amendment to the definition "majority-interest partner" in subsection 248(1). For further information, see the commentary on that definition.

This amendment comes into force on Royal Assent.

Clause 13

Capital gains and losses – general rules

ITA

40

Section 40 of the Act provides rules for determining a taxpayer's gain or loss from the disposition of capital property.

ITA

40(3.4)(b)(iii)

Subsections 40(3.3) to (3.6) of the Act defer, in certain circumstances, the realization of a loss that would otherwise arise from certain dispositions by a corporation, trust or partnership (the transferor) of a non-depreciable capital property. If the transferor or an affiliated person acquires the property (or an identical property) in the period that begins 30 days before the disposition and ends 30 days after the disposition and the transferor or an affiliated person owns the property at the end of that period, the transferor's loss from the disposition is deemed to be nil and the loss is suspended until the earliest of certain so-called "release events" described in subparagraph 40(3.4)(b)(i) to (v).

One such release event, described in subparagraph 40(3.4)(b)(iii), is, if the transferor is a corporation, the acquisition of control of the transferor. Subparagraph 40(3.4)(b)(iii) is amended, to extend its application to trusts, by referring to a transferor that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

ITA

40(10) and (11)

Subsections 40(10) and (11) of the Act provide a mechanism for the computation of the gain or loss on a foreign currency debt that takes into account the impact of gains and losses already recognized in respect of a foreign currency debt because of subsection 111(12). Subsection 111(12) extends the general treatment of accrued capital gains and losses on an acquisition of control of a corporation to apply also to a corporation's accrued capital gains and capital losses resulting from foreign currency fluctuations on debt liabilities denominated in a foreign currency. The mechanism under subsections 40(10) and (11) is necessary because, unlike gains and losses in respect of property, gains and losses from a fluctuation in the value of the currency of a foreign currency debt of the corporation are not referable to a cost base that may be adjusted to account for previously recognized gains and losses.

Subsections 40(10) and (11) are amended to extend their application to trusts. These changes are consequential on the extension of the rules in subsection 111(4) and (12) to trusts. For further information, see the commentary on sections 111 and 251.2.

These amendments come into force on March 21, 2013.

Clause 14**Adjustments to cost base**

ITA

53

Section 53 of the Act contains rules for determining the adjusted cost base (ACB) of property. Certain adjustments are made under this section. Subsection 53(1) provides for additions in computing the ACB of a property. Subsection 53(2) provides for deductions in computing the ACB of a property.

ACB adjustment – derivative forward agreement

ITA

53(1)(s) and (t)

New paragraphs 53(1)(s) and (t) of the Act provide an increase in the adjusted cost base of a property where there has been an inclusion in the computation of a taxpayer's income because of paragraph 12(1)(z.7). This adjustment is provided to ensure that an amount included in computing a taxpayer's income under paragraph 12(1)(z.7) is not taxed again as a capital gain.

Paragraph 53(1)(s) applies in respect of a purchase of property under a derivative forward agreement. Any amount required to be included in respect of the purchase of the property under subparagraph 12(1)(z.7)(i) is added to the adjusted cost base of the property.

Paragraph 53(1)(t) applies in respect of a sale of property under a derivative forward agreement. Any amount required to be included in respect of the sale of the property under subparagraph 12(1)(z.7)(ii) is added to the adjusted cost base of the property. This adjustment occurs for the year of sale so that it is taken into account in computing any gain or loss on the sale.

An income inclusion is provided in paragraph 12(1)(z.7) where a derivative forward agreement results in a profit. A deduction is provided in paragraph 20(1)(xx) where a derivative forward agreement results in a loss. A decrease in the adjusted cost base of the capital property is provided in paragraphs 53(2)(w) and (x) where an amount is deductible under paragraph 20(1)(xx).

For further information, see the commentary on paragraphs 12(1)(z.7), 20(1)(xx) and 53(2)(w) and (x) and the definition "derivative forward agreement" in subsection 248(1).

Paragraphs 53(1)(s) and (t) come into force on March 21, 2013.

ACB adjustment – loss restriction event

ITA

53(2)(b.2)

Paragraph 53(2)(b.2) of the Act requires a deduction in computing the ACB of non-depreciable capital property of a corporation that has been subject to an acquisition of control. The amount of the deduction is determined under paragraph 111(4)(c).

Paragraph 53(2)(b.2) is amended to extend its application to trusts, consequential on an amendment to subsection 111(4) to extend that subsection to trusts. Amended subsection 111(4) applies to a taxpayer that is a corporation or trust as a result of the taxpayer being subject to a loss restriction event. For further information, see the commentary on sections 111 and 251.2.

This amendment comes into force on March 21, 2013.

ACB adjustment – derivative forward agreement

ITA

53(2)(w) and (x)

New paragraphs 53(2)(w) and (x) of the Act provide a decrease in the adjusted cost base of a property where there is an amount deductible under paragraph 20(1)(xx) in computing a taxpayer's income. This adjustment is provided to ensure that an amount deductible in computing a taxpayer's income under paragraph 20(1)(xx) cannot be deducted as a capital loss.

Paragraph 53(2)(w) applies in respect of a purchase of the property under a derivative forward agreement. Any amount deductible in computing the taxpayer's income in respect of the purchase of the property under paragraph 20(1)(xx) is subtracted from the adjusted cost base of the property.

Paragraph 53(2)(x) applies in respect of a sale of the property under a derivative forward agreement. Any amount deductible in computing the taxpayer's income in respect of the sale of the property under paragraph 20(1)(xx) is subtracted from the adjusted cost base of the property. This adjustment occurs for the year of sale so that it is taken into account in computing any gain or loss on the sale.

An income inclusion is provided in paragraph 12(1)(z.7) where a derivative forward agreement results in a profit. A deduction is provided in paragraph 20(1)(xx) where a derivative forward agreement results in a loss. An increase in the adjusted cost base of the capital property purchased or sold is provided in paragraphs 53(1)(s) and (t) where an amount is included in a taxpayer's income under paragraph 12(1)(z.7).

For further information, see the commentary on paragraphs 12(1)(z.7), 20(1)(xx) and 53(1)(s) and (t) and the definition "derivative forward agreement" in subsection 248(1).

Paragraphs 53(2)(w) and (x) come into force on March 21, 2013.

Clause 15

Definition "superficial loss"

ITA

54

Section 54 of the Act contains various definitions that apply for the purposes of subdivision C – Taxable Capital Gains and Allowable Capital Losses.

"superficial loss"

The definition "superficial loss" in section 54 excludes losses on dispositions listed in paragraphs (c) to (h) of the definition from being superficial losses. Paragraph (c) of the definition is amended to remove its reference to paragraph 33.1(11)(a), which has been repealed.

This amendment applies to taxation years that begin after March 20, 2013.

Paragraph (f) of the definition describes a disposition by a corporation control of which has been acquired within 30 days after the disposition. Paragraph (f) of the definition is amended to extend its application to trusts, by referring to a taxpayer that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

Clause 16

Amounts to be included in income

ITA

56(1)(a)

Subparagraph 56(1)(a)(i) of the Act includes in the income of a taxpayer for a taxation year certain pension benefits received by the taxpayer in the year, with the exceptions listed in clauses 56(1)(a)(i)(D) to (F).

Subparagraph 56(1)(a)(i) is amended to add new clause 56(1)(a)(i)(G) to exempt from inclusion in the income of a taxpayer an amount paid out of a registered pension plan (RPP) as a refund of contributions made to the RPP where:

- the refund is described under section 147.1(19) of the Act (i.e., a refund of contributions made as a result of a reasonable error) or subparagraph 8502(d)(iii) of the *Income Tax Regulations* (i.e., a refund to avoid the revocation of registration of the RPP); and
- the amount is not deducted as an RPP contribution for the taxation year in which the refund is made or for any preceding taxation year.

For further information, see the commentary on new subsection 147.1(19) regarding refunds of contributions made to an RPP as a result of a reasonable error.

This amendment applies to contributions made on or after the later of January 1, 2014 and the day on which Royal Assent is received.

Clause 17

Resource expenses

ITA

66

Section 66 of the Act provides rules in respect of Canadian and foreign exploration and development expenses.

Loss restriction event

ITA

66(11.4) and (11.5)

Subsection 66(11.4) of the Act applies if a corporation, or a partnership of which a corporation is a majority-interest partner, acquires a Canadian resource property or foreign resource property (subject to an exception for property transferred among affiliated persons including the corporation or partnership) within the 12-month period that ends immediately before an acquisition of control of the corporation. If the corporation was not a principal-business corporation immediately before that period, two rules apply for purposes of subsection 66(4) and sections 66.2, 66.21 and 66.4. First, if the property was disposed of and not reacquired before the acquisition of control, the property is treated as having been acquired immediately before the disposition. Second, if the first rule does not apply, the property is treated as not having been acquired until after the acquisition of control.

Subsection 66(11.4) is amended to extend its application to trusts. Specifically, the subsection applies if a taxpayer that is a corporation or trust, a partnership of which the taxpayer is a majority-interest partner or, on or after Announcement Date, a trust of which the taxpayer is a majority-interest beneficiary, acquires a Canadian resource property or foreign resource property within the 12-month period that ends immediately before the taxpayer is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

If a taxpayer referred to in subsection 66(11.4) is formed shortly before it became subject to a loss restriction event, the exception provided in that subsection for transfers among affiliated persons will not apply. Specifically, the acquired property will not be able to meet the test of having been held by the taxpayer or by an affiliated person throughout the relevant period. Subsection 66(11.5) ensures the appropriate result under subsection 66(11.4) in such a case. Subsection 66(11.5) treats a newly-formed

corporation or trust as having been in existence from the time immediately before the relevant 12-month period to the time immediately after it was formed, and as having been affiliated during that time with the persons with whom it was affiliated from its formation until it is subject to a loss restriction event.

Subsection 66(11.5) is amended to extend its application to trusts, consequential on the extension of subsection 66(11.4) to trusts. The references in subsection (11.5) to “incorporated or otherwise formed” have been changed to “formed or created” to account for trusts.

These amendments come into force on March 21, 2013.

Loss restriction event – application of 66.7

ITA

66(11.6)

Section 66.7 of the Act provides rules (commonly known as the “successor rules”) in respect of certain resource expenses. The successor rules establish the parameters within which unused resource expenses of an “original owner” may be deducted by a corporation (the successor) following an acquisition of resource properties by the successor. Specifically, a successor generally may deduct the unused resource expenses of the original owner only to the extent of the successor’s income from the resource properties acquired from the original owner.

The successor rules also apply, by operation of subsection 66.7(10), to limit the deduction of a corporation’s own resource expenses if there has been an acquisition of control of the corporation by a person or group of persons. Subsection 66.7(10) in effect treats the corporation as a successor that at the time of the acquisition of control acquired all its property from an original owner. As a result, the deductions otherwise available in respect of resource expenses incurred by the corporation before the acquisition of control are subject to the limitations in the successor rules.

New subsection 66(11.6) extends the rules in subsection 66.7(10) to a trust that is at a particular time subject to a loss restriction event. Under subsection 66(11.6), a trust is deemed, for the purposes of the income tax rules relating to the deduction of certain resource expenses, to be a successor corporation that acquired, at the particular time from an original owner, all of the properties held by the trust at the particular time. Under the successor rules as they apply to trusts, the trust’s resource expenses from before the particular time will be deductible only against the trust’s income from, or in respect of the disposition of, properties owned at the particular time. If the trust is a member of a partnership at the particular time, the trust is treated as owning a proportionate share of the partnership’s resource properties and as having a specified share, determined under clause 66(11.6)(a)(vi)(B), of the partnership’s income in respect of those properties.

A trust’s ability to deduct expenses in respect of its resource properties held at the particular time it is subject to a loss restriction event is further restricted by the anti-avoidance rule contained in paragraph 66(11.6)(b). That rule applies if the trust acquires certain resource properties and it can reasonably be considered that one of the main purposes of the acquisition is to avoid a limitation under the successor rules on the deduction of expenses incurred by the trust. In these circumstances, the trust is deemed not to have acquired the property, with the result that no resource expense deductions are available to the trust in respect of the property.

The trust’s status as a corporation under the successor rules is limited to applying those rules to the trust itself. In addition, under subparagraph 66(11.6)(a)(vii), a trust’s unused resource expenses in

respect of property that is held by the trust at the particular time it is subject to a loss restriction event cannot be, on a subsequent disposition of the property by the trust, deducted by any person.

For further information on loss restriction events, see the commentary on section 251.2.

New subsection 66(11.6) comes into force on March 21, 2013.

Expenses in the first 60 days of the year

ITA

66(12.66)(b)(ii)

Subsection 66(12.66) of the Act permits a corporation to renounce Canadian exploration expense (CEE) and Canadian development expense (CDE) to a flow-through shareholder within defined limits. Where the conditions described in subsection 66(12.66) are met, the corporation may renounce in January, February or March of a particular calendar year, effective as of the end of the preceding calendar year, the expenses described in subsection 66(12.66) that the corporation has incurred, or plans to incur, in the particular year. In other words, subsection 66(12.66) provides a “look-back” period of one year.

Subparagraph 66(12.66)(b)(ii) is amended to add references to paragraphs (g.2), (g.3) and (g.4) of the definition of CEE in subsection 66.1(6). Consistent with the dates of introduction for these paragraphs, this amendment comes into force on March 22, 2011 with respect to the reference to paragraph (g.2) and on March 21, 2013 with respect to the reference to paragraphs (g.3) and (g.4).

Clause 18

Canadian exploration expense

ITA

66.1

Section 66.1 of the Act provides rules relating to the deduction of Canadian exploration expense (as defined in subsection 66.1(6)).

Definitions

ITA

66.1(6)

Subsection 66.1(6) of the Act provides definitions for the purposes of section 66.1.

“Canadian exploration expense”

The definition “Canadian exploration expense” (CEE) in subsection 66.1(6) defines oil, gas, mining, and Canadian renewable and conservation expenses that qualify for treatment as CEE, which expenses are fully deductible in the taxation year incurred or in a future taxation year.

The definition of CEE is amended to implement the transition from CEE to Canadian development expense (CDE) for expenses incurred after March 20, 2013 for the purpose of bringing a new mine in a mineral resource in Canada (other than an oil sands mine) into production in reasonable commercial quantities (i.e., the expenses described in paragraph (g) of the definition of CEE, which are referred to in this commentary as “eligible pre-production mine development expenses”). The definition of CEE is amended in four respects.

First, paragraph (g) of the definition of CEE is amended to ensure that only eligible pre-production mine development expenses incurred before March 21, 2013 are treated as CEE.

Second, new paragraph (g.3) is added to the definition of CEE to provide for grandfathering of CEE treatment for two types of eligible pre-production mine development expenses that are incurred before 2017. In particular, subparagraph (g.3)(i) ensures that eligible pre-production mine development expenses that are incurred under a written agreement entered into by a taxpayer before March 21, 2013 will continue to be treated as CEE. In addition, subparagraph (g.3)(ii) provides that eligible pre-production mine development expenses incurred (before 2017) for the development of a new mine will continue to be treated as CEE, if either the construction, or the engineering and design work for the construction, of the new mine was started by, or on behalf of, the taxpayer before March 21, 2013. The evidence of the commencement before March 21, 2013 of the engineering and design work for the construction of the new mine must be in writing. For these purposes, the following activities are not considered construction or the engineering and design work for the construction of the mine:

- obtaining permits or regulatory approvals;
- conducting environmental assessments, community consultations or impact benefit studies; and
- any other similar activities.

Third, new paragraph (g.4) is added to the definition of CEE to phase in the transition from CEE to CDE of the eligible pre-production mine development expenses incurred after March 20, 2013. A portion of the eligible pre-production mine development expenses, if incurred by a taxpayer before 2018, will continue to qualify as a CEE of the taxpayer based on the following rates: 100% of the expense in 2013 and 2014, 80% of the expense in 2015, 60% of the expense in 2016, and 30% of the expense in 2017. The remainder of the expense will qualify as a CDE of the taxpayer. Therefore, a taxpayer may allocate eligible pre-production mine development expenses proportionally between two resource expense categories – CEE and CDE – based on the year in which the expense is incurred.

Fourth, paragraph (h) of the definition CEE is amended to add references to paragraphs (g.2), (g.3) and (g.4). Consistent with the dates of introduction for these paragraphs, this amendment comes into force on March 22, 2011 with respect to the reference to paragraph (g.2) and on March 21, 2013 with respect to the reference to paragraphs (g.3) and (g.4).

“eligible oil sands mine development expense”

The definition “eligible oil sands mine development expense” is important in determining the proportion of oil sands mine development expenses incurred over the calendar years 2011-2015 transition period that is treated as CEE. A taxpayer may allocate pre-production oil sands mine development expense incurred after March 21, 2011 and before 2016, proportionally to the two resource expense categories based on the year in which the expense is incurred; respectively as 100% CEE in 2011 and 2012, 80% CEE and 20% CDE in 2013, 60% CEE and 40% CDE in 2014, and 30% CEE and 70% CDE in 2015.

The definition is amended consequential on the amendments to paragraph (g) of the definition CEE to phase in the transition from CEE to CDE for eligible pre-production mine development expenses incurred after March 20, 2013. This amendment ensures that the appropriate portion of the eligible oil sands mine development expenses incurred after March 20, 2013 will continue to be treated as CEE.

This amendment comes into force on March 21, 2013.

“specified oil sands mine development expense”

A “specified oil sands mine development expense” means an expense incurred by a taxpayer after March 21, 2011 and before 2015, to achieve completion of a specified oil sands mine development project of the taxpayer, that would be a CEE described in paragraph (g) of the definition of CEE if that paragraph were read without reference to the words “other than a bituminous sands deposit or an oil shale deposit”.

The definition is amended to provide that, for the purposes of specified oil sands mine development expense, paragraph (g) of the definition of CEE is to be read without reference to the phrase “before March 21, 2013”. This amendment ensures that specified oil sands mine development expense incurred after March 20, 2013 will continue to be treated as CEE.

This amendment comes into force on March 21, 2013.

Clause 19

Canadian development expense

ITA

66.2

Section 66.2 of the Act provides rules relating to the deduction of “Canadian development expense”, as defined in subsection 66.2(5).

Definitions

ITA

66.2(5)

Subsection 66.2(5) of the Act contains the definitions “Canadian development expense” and “cumulative Canadian development expense”.

“Canadian development expense”

New paragraph (c.2) is added to the definition “Canadian development expense” (CDE) to include any expense incurred in bringing a new mine in a mineral resource in Canada (other than an oil sands mine) into production in reasonable commercial quantities, including an expense for clearing the land, removing overburden and stripping, sinking a mine shaft or constructing an adit or other underground entry. Paragraph (c.2) does not include an expense or any portion of an expense described in paragraphs (g.3) or (g.4) of the definition of CEE.

This amendment comes into force on March 21, 2013.

Clause 20

Death of a taxpayer

ITA

70

Section 70 of the Act provides certain rules that apply on the death of a taxpayer.

ITA

70(5.31)

Subsection 70(5) of the Act provides for the deemed disposition of a taxpayer's capital property on the taxpayer's death for proceeds equal to the property's fair market value immediately before the death. A special rule in subsection 70(5.3) applies where a life insurance policy is relevant to determining the fair market value of a property deemed disposed of under subsection 70(5) – for example, where the deceased taxpayer's property includes shares of the capital stock of a corporation and the corporation is the owner of a life insurance policy under which the taxpayer's life was insured. In this case, the fair market value of the property is determined under subsection 70(5.3) as if the value of the policy were the policy's cash surrender value immediately before the taxpayer's death. This rule also applies in respect of deemed dispositions under subsection 104(4) of trust property on the death of a trust beneficiary and under section 128.1 on the change of residence of a taxpayer.

New subsection 70(5.31) provides a similar special valuation rule for the purposes of determining the fair market value of property deemed disposed of, due to the death of a taxpayer, under subsections 70(5) and 104(4). The rule applies where the deceased taxpayer's life was insured under an LIA policy and an annuity contract issued in respect of an LIA policy is relevant to determining the fair market value of the property that is deemed to have been disposed of. In this case, the fair market value of the annuity contract is, in effect, deemed to be the total of the premiums paid under the annuity contract until the time immediately before the taxpayer's death.

For further information on LIA policies, see the commentary on the definition "LIA policy" in subsection 248(1).

This amendment applies to taxation years that end after March 20, 2013.

Clause 21**Revocable trusts and exceptions**

ITA

75(2) and (3)

Subsection 75(2) of the Act generally provides for the attribution to a person resident in Canada of income and losses derived from certain trust property where the property was received by the trust from the person and can revert to the person (or pass to other persons determined by that person). Subsection 75(3) exempts property held by certain trusts from this attribution rule.

Subsection 75(2) is amended to provide that a trust must be resident in Canada in order for the subsection to apply in respect of property held by the trust. A related amendment to paragraph 94(4)(h) provides that paragraph 94(3)(a) will not apply for the purpose of determining whether subsection 75(2) applies. As a consequence, subsection 75(2) will apply only in respect of property held by a trust that is resident in Canada (determined without regard to the deemed residence rule in subsection 94(3)).

Consequential on the amendment to subsection 75(2), subsection 75(3) is amended to replace its paragraphs (c) to (c.3) with new paragraph (c). The references in paragraphs (c) to (c.3) to non-resident trusts, and to an electing contributor (as defined in subsection 94(1)) in respect of a non-resident trust, are unnecessary because amended subsection 75(2) will not apply in respect of property held by a non-resident trust. New paragraph 75(3)(c) replaces existing paragraph 75(3)(c.1) –

subsection 75(2) will continue not to apply in respect of property held by a qualifying environmental trust.

For further information, see the commentary on subsections 94(8.1) and (8.2) and paragraph 94(4)(h). These amendments apply to taxation years that end after March 20, 2013.

Clause 22

Debt forgiveness

ITA
80

Section 80 of the Act contains rules that apply in respect of the forgiveness of certain debt obligations.

Definitions

ITA
80(1)

Subsection 80(1) of the Act contains definitions that apply for purposes of section 80 and certain related rules.

“relevant loss balance”

Under subsections 80(3) and (4), a forgiven amount in respect of debt issued by a debtor is applied at the time that the debt is settled to reduce the debtor’s loss balances (i.e., loss carry over amounts). The amount by which a loss for a year may be reduced under those subsections is limited to the relevant loss balance for the relevant obligation and in respect of that loss. The relevant loss balance of a corporate debtor for an obligation and in respect of a net capital loss, non-capital loss, farm loss or restricted farm loss for a previous year is deemed to be nil after an acquisition of control of the debtor that occurred after that previous year unless the obligation was issued before, and not in contemplation of, that acquisition of control, or all or substantially all of the proceeds from issuing that obligation were (directly or indirectly) used to refinance a qualifying obligation.

The definition “relevant loss balance” is amended to extend to trusts, by referring to a taxpayer that is subject to a loss restriction event, the rule that deems the relevant loss balance of certain obligations to be nil. For further information, see the commentary on sections 111 and 251.2.

This amendment comes into force on March 21, 2013.

“unrecognized loss”

Subsection 80(13) includes an amount in computing the income of a debtor for the taxation year in respect of the remaining unapplied portion of the forgiven amount in respect of a commercial obligation settled in the year. The amount of a debtor’s “unrecognized loss” (as defined in subsection 80(1)) can be used to offset the amount otherwise included under subsection 80(13) in computing the debtor’s income. Subject to exceptions where there has been an acquisition of control of the debtor, a debtor’s unrecognized loss from the disposition of property is equal to the total capital losses from the disposition of the property that are denied under subparagraph 40(2)(g)(ii). In the case of a corporate debtor control of which was acquired after the unrecognized loss was realized, the unrecognized loss at any later time is deemed to be nil, unless the obligation was issued before, and not in contemplation of, that acquisition of control, or all or substantially all of the proceeds from issuing that obligation were (directly or indirectly) used to refinance a qualifying obligation.

The definition “unrecognized loss” is amended to extend to trusts, by referring to a taxpayer that is subject to a loss restriction event. For further information, see the commentary on sections 111 and 251.2.

This amendment comes into force on March 21, 2013.

Members of partnerships

ITA

80(15)(c)

Under subsection 80(15) of the Act, a member of a partnership is allowed a deduction not exceeding the amount that would, if the partnership had designated amounts to the maximum extent permitted under subsections 80(5) to (10) in respect of the forgiven amount of an obligation issued by it, have been included as the member’s share of any income resulting from the application of subsection 80(13). (Subsection 80(13) includes an amount in computing the income of a debtor for the taxation year in respect of the remaining unapplied portion of the forgiven amount in respect of a commercial obligation settled in the year.) For this purpose, income resulting from subsection 80(13) is considered to arise from a separate source so that current year partnership expenses do not have any impact on the computation of the deduction. However, if a member of a partnership does deduct such an amount, the member is deemed to have issued a commercial obligation that was settled at the end of the fiscal period of the partnership in which the partnership’s obligation was settled. The amount of such deduction claimed by the partner is treated as if it were the forgiven amount in respect of the deemed obligation.

Under subsection 80(15), a deemed obligation is generally treated as having been issued at the same time and in the same circumstances as the partnership obligation that gives rise to the application of subsection 80(13). In addition, for the purpose of applying subsection 80(13) in respect of the deemed obligation, the source in connection with which the deemed obligation was issued is deemed to be the source in connection with which the partnership obligation was issued.

If the member is a corporation the control of which was acquired after the time that an obligation is deemed by subsection 80(15) to be issued and before the corporation became a member of the partnership, the obligation is considered under subparagraph 80(15)(c)(iv) to have been issued after the time of the acquisition of control (or after a later acquisition of control, where relevant). As a consequence, the corporation is not able to apply the deemed forgiven amount under subsection 80(15) against losses arising before an acquisition of control in these circumstances.

Subparagraph 80(15)(c)(iv) is amended to extend its application to trusts. Specifically, the amended subparagraph applies if the relevant partnership member is a taxpayer that is a trust or corporation that was subject to a loss restriction event at the relevant time. The deemed forgiven amount under subsection 80(15) cannot be applied against the taxpayer’s losses arising before the loss restriction event.

This amendment comes into force on March 21, 2013.

Clause 23

Agreement respecting transfer of forgiven amount

ITA

80.04

Section 80.04 of the Act contains rules that allow a debtor to enter into an agreement with an eligible transferee in order for the debtor to minimize the tax consequences to the debtor under section 80 from the settlement of debt issued by the debtor.

ITA

80.04(4)(h)

Paragraphs 80.04(4)(e) to (j) of the Act set out the rules that apply where a debtor and an eligible transferee make a valid election in respect of a particular debt for which a forgiven amount arises under section 80 on settlement of the particular debt. Generally, the transferee is deemed to have issued a commercial debt obligation that was issued at the same time as and in similar circumstances, and also settled at the same time as, the particular debt. However, under paragraph 80.04(4)(h), if the transferee is a corporation the control of which was acquired after the time of issue of the deemed obligation and the transferee corporation and the debtor were not related to each other immediately before that acquisition of control, the deemed obligation is treated as having been issued after the acquisition of control. As a result, the transferee is not able to apply the forgiven amount against losses arising before the acquisition of control.

Paragraph 80.04(4)(h) is amended to extend to trusts, by referring to a taxpayer that is subject to a loss restriction event. For further information, see the commentary on sections 111 and 251.2.

This amendment comes into force on March 21, 2013.

Clause 24

Synthetic disposition – deemed disposition

ITA

80.6

New subsection 80.6(1) of the Act is introduced to generally provide that a taxpayer who owns a property and who enters into a synthetic disposition arrangement in respect of it is deemed to have disposed of the property for proceeds equal to its fair market value and to have immediately reacquired the property at that fair market value. The subsection ensures that taxpayers cannot defer the tax consequences of disposing of a property by entering into a synthetic disposition arrangement.

The deemed disposition under subsection 80.6(1) occurs at the beginning of the synthetic disposition period in respect of the synthetic disposition arrangement. The new terms “synthetic disposition arrangement” and “synthetic disposition period” are defined in subsection 248(1).

Subsection 80.6(1) applies to synthetic disposition arrangements with a synthetic disposition period of at least one year. The synthetic disposition period is essentially the period for which all or substantially all the taxpayer’s risk of loss and opportunity for gain or profit in respect of a property have been eliminated.

Subsection 80.6(2) sets out a number of exceptions to the deemed disposition rule in subsection 80.6(1). Paragraph 80.6(2)(a) provides that subsection 80.6(1) does not apply unless the deemed

disposition would result in the realization of a capital gain or in an income inclusion. The deemed disposition therefore occurs in circumstances where there is the potential for a deferral of tax. Paragraph 80.6(2)(b) provides that subsection 80.6(1) does not apply in respect of mark-to-market property, in which case there is an annual realization event, making a deemed disposition in the year unnecessary. Paragraph 80.6(2)(c) provides that subsection 80.6(1) does not apply to a synthetic disposition arrangement that is a lease of tangible property, or for civil law purposes, corporeal property. It is not intended that the synthetic disposition rule displace the existing tax rules with respect to these leases.

Paragraphs 80.6(2)(d) provides that subsection 80.6(1) does not apply to an exchange of property to which subsection 51(1) applies. Subsection 51(1) generally permits a tax-deferred transfer of property where a taxpayer, pursuant to a right of conversion, exchanges capital property that is a share, bond, debenture or note of a corporation for other capital property that is a share of the capital stock of the corporation. Paragraph 80.6(2)(e) provides that subsection 80.6(1) does not apply if the property is otherwise disposed of, as part of the arrangement, within one year after the day on which the synthetic disposition period of the arrangement begins. Subsection 51(1) rollovers do not fall within the ambit of paragraph 80.6(2)(e) because there is no deemed disposition under subsection 51(1). Several other provisions of the Act allow for the tax-deferred transfer of property in certain circumstances (e.g., subsections 85(1), 85.1(1) and 86(1)) and in those cases paragraph 80.6(2)(e) would apply.

Example

John owns shares of ABC Co. that have an adjusted cost base of \$1 million and a fair market value of \$10 million. If John sold the shares outright, he would realize a \$9 million capital gain. John, however, wants to sell the shares without any immediate tax consequences. In order to effectively sell the shares while deferring tax on the accrued capital gain, John enters into a synthetic disposition arrangement.

John receives a five-year loan for \$10 million from a purchaser (with interest of \$2 million payable in five years). Under the arrangement, John obtains a right to settle the loan (including accrued interest) in five years by transferring the ABC Co. shares to the purchaser and the purchaser obtains a right to acquire the shares from John in five years for \$12 million. As a result, John has eliminated his risk of loss and opportunity for gain or profit in respect of the ABC Co. shares. If the value of the shares is less than \$12 million in five years, John would settle the loan by transferring ownership of the shares to the purchaser. If the value of the shares is greater than \$12 million in five years, the purchaser would exercise the right to acquire the shares for \$12 million.

Under section 80.6, John will be deemed to have disposed of the ABC Co. shares at their fair market value of \$10 million when he enters into the arrangement and will be deemed to have immediately reacquired the shares at a cost of \$10 million. As a result, John will have an immediate capital gain of \$9 million.

In five years, John will dispose of the shares for proceeds of \$12 million (either to settle the \$12 million debt or to settle the purchaser's right to acquire the shares for \$12 million), which will exceed the \$10 million adjusted cost base of the ABC Co. shares to John at that time. As a result of the application of new paragraph 12(1)(z.7), John will have a \$2 million income inclusion and no additional capital gain will result from the final disposition.

Section 80.6 applies to agreements and arrangements entered into after March 20, 2013. It also applies to an agreement or arrangement entered into before March 21, 2013, the term of which is extended after March 20, 2013, and it applies to the agreement or arrangement as if the agreement or arrangement were entered into at the time of the extension.

Clause 25

Rules applicable to amalgamations

ITA

87(2)

Subsection 87(2) of the Act applies where two or more taxable Canadian corporations amalgamate to form a new corporation.

ITA

87(2)(g.1)

Paragraph 87(2)(g.1) of the Act provides that, for certain purposes, a new corporation formed as a result of an amalgamation is to be treated as a continuation of each predecessor corporation. Paragraph 87(2)(g.1) is amended consequential on the introduction of the new corporate loss trading rules in section 256.1 to add a reference to section 256.1.

By reason of paragraph 88(1)(e.2), which refers to paragraph 87(2)(g.1), the provision also applies for the purposes of section 256.1 to a parent in respect of a wholly-owned subsidiary that has been wound up under subsection 88(1).

This amendment comes into force on March 21, 2013.

Clause 26

Definitions

ITA

89(1)

Subsection 89(1) of the Act defines certain terms that apply to corporations and their shareholders.

“capital dividend account”

Where the appropriate elections have been made by a private corporation, dividends paid out of the capital dividend account of the corporation are received tax-free by the corporation’s shareholders who are resident in Canada.

Paragraph (d) of the definition “capital dividend account” includes in computing the capital dividend account of a corporation the amount of certain net life insurance proceeds (proceeds minus the adjusted cost base to the corporation of the policy) received by the corporation in consequence of the death of any person.

Paragraph (d) of the definition is amended so that a corporation’s capital dividend account is not increased by any amount received in respect of an LIA policy. That paragraph is also amended to reduce the amount otherwise included under that paragraph in a corporation’s capital dividend account by certain specified amounts, in respect of deaths that occur after 2013, under a 10/8 policy. Those amounts are the amount of any 10/8 borrowing, in respect of the 10/8 policy, that remained outstanding immediately before the relevant death. For further information, see the commentary on the definitions “LIA policy” and “10/8 policy” in subsection 248(1).

Finally, paragraph (d) of the definition is also amended to update its structure to conform to modern drafting standards.

These amendments apply to taxation years that end after March 20, 2013.

Clause 27

Non-resident trusts

ITA

94

Section 94 of the Act sets out rules in respect of certain non-resident trusts in respect of which a Canadian resident, or former Canadian resident, is a contributor. In general, if a Canadian resident contributes property to a non-resident trust (other than an exempt foreign trust), the trust is deemed under paragraph 94(3)(a) to be resident in Canada for a number of purposes, and the contributor (except electing contributors), the trust and certain Canadian-resident beneficiaries of the trust may all become jointly and severally, or solidarily, liable to pay Canadian tax on the income of the trust.

Excluded provisions

ITA

94(4)(h)

Subsection 94(4) of the Act provides that the rules in paragraph 94(3)(a) that deem a non-resident trust to be resident in Canada do not apply for various enumerated purposes. These enumerated purposes include, as provided under paragraph 94(4)(h), determining whether subsection 75(2) applies to deem an amount to be an income, loss, taxable capital gain or allowable capital loss of the non-resident trust. Accordingly, the non-resident trust is considered not to be a Canadian-resident person in determining whether amounts are attributable to the trust from another trust under that subsection.

Paragraph 94(4)(h) is amended to provide that paragraph 94(3)(a) will also not apply for the purpose of determining whether subsection 75(2) applies. Subsection 75(2) continues not to apply to attribute amounts to another trust that would otherwise be deemed resident under subsection 94(3) and, as a result of this amendment, subsection 75(2) will also not apply to attribute amounts from a trust that is itself deemed resident under subsection 94(3). For further information, see the commentary on subsections 75(2) and 94(8.1) and (8.2).

This amendment applies to taxation years that end after March 20, 2013.

Effective ownership

ITA

94(8.1) and (8.2)

Section 94 of the Act is amended to add new subsections 94(8.1) and (8.2). The subsections ensure that the deemed residence rules for trusts in section 94 apply in respect of a trust that holds property on conditions that grant effective ownership of the property to a Canadian-resident person.

New subsection 94(8.1) provides for the conditions of application of new subsection 94(8.2).

Subsection 94(8.2) will apply at any time to a particular person and to a particular property, in respect of a non-resident trust, if at that time

- the particular person is resident in Canada; and

- the trust holds the particular property on condition that the particular property or property substituted for the particular property
 - may revert to the particular person, or may pass to one or more persons or partnerships to be determined by the particular person, or
 - shall not be disposed of by the trust during the existence of the particular person, except with the particular person's consent or in accordance with the particular person's direction.

If the conditions of application in subsection 94(8.1) are satisfied at any time in respect of a particular person and a particular property held by a trust, then subsection 94(8.2) applies to, in effect, treat the particular person as having contributed to the trust the particular property (or, depending upon the circumstances, certain connected property, such as property for which the particular property is a substitute or property from which the particular property derives value). Specifically, subsection 94(8.2) provides that in applying the deemed residence rules in section 94 in respect of the trust for a taxation year of the trust that includes that time

- every transfer or loan made at or before that time by the particular person (or by a trust or partnership of which the particular person was a beneficiary or member) of the particular property, of another property for which the particular property is a substitute, or of property from which the particular property derives, or the other property derived, its value in whole or in part, directly or indirectly, is deemed to be a transfer or loan, as the case may be, by the particular person of restricted property; and
- paragraph 94(2)(c) is to be read without reference to subparagraph 94(2)(c)(iii) in its application to each such transfer and loan.

By deeming the relevant transfers and loans to be transfers and loans of restricted property, those transactions will not be arm's length transfers (as defined in subsection 94(1)), with the result that a number of extended transfer rules in subsection 94(2) will apply and the relevant transfers and loans will be considered contributions (as defined in subsection 94(1)) to the trust by the particular person. In addition, subsection 94(9) will apply to determine the amount of the resulting contribution. Since the particular person will be resident in Canada, to the extent that the particular person is a contributor and resident contributor (as defined under subsection 94(1)) to the trust, the trust will be deemed to be resident in Canada under paragraph 94(3)(a), subject to the exemption for exempt foreign trusts.

These amendments apply to taxation years that end after March 20, 2013.

Clause 28

Distributions from a trust

ITA

107(4.1)(b), (c) and (d)

Subsection 107(2) of the Act allows certain trusts to distribute property to a capital beneficiary under the trust on a tax-deferred (i.e., rollover) basis. Subsection 107(4.1) prevents subsection 107(2) from applying to a distribution of trust property to a beneficiary under the trust where, generally, the trust attribution rule in subsection 75(2) was at any time applicable in respect of property of the trust.

Paragraph 107(4.1)(b) provides that one of the conditions for the application of subsection 107(4.1) is that subsection 75(2) was applicable in respect of certain enumerated property. For this purpose, the

determination of whether subsection 75(2) was applicable is made as though the subsection can apply to attribute amounts to a non-resident person and to a person in respect of which amounts are attributed under section 94 because the person is an electing contributor.

Paragraph 107(4.1)(b) is amended to provide that subsection 107(4.1) can also apply if new subsection 94(8.2) was applicable in respect of the same enumerated property. Subsection 94(8.2) applies in the circumstances described in subsection 94(8.1) involving a particular person having effective ownership of particular property held by a trust. For the purposes of paragraph 107(4.1)(b), the determination of whether subsection 94(8.2) was applicable is made as though a particular person described in subsection 94(8.1) can be a non-resident person. For further information, see the commentary on subsections 94(8.1) and (8.2).

Under paragraph 107(4.1)(c), subsection 107(4.1) applies if the beneficiary to whom the relevant distribution is made is not a qualifying beneficiary. A qualifying beneficiary is the specified person to whom amounts are attributable under subsection 75(2) as described in paragraph 107(4.1)(b) in respect of the distribution (i.e., including a person to whom amounts are treated as being attributable under that subsection for the purposes only of that paragraph). A qualifying beneficiary also includes the specified person's Canadian-resident spouse or common-law partner and a Canadian-resident trust to which the specified person is eligible to transfer property as described in section 73.

Paragraph 107(4.1)(c) is amended consequential on the amendment to paragraph 107(4.1)(b). Specifically, paragraph 107(4.1)(c) is extended to provide that a qualifying beneficiary is, where paragraph 107(4.1)(b) applies in respect of the application of subsection 94(8.2), the particular person referred to in that subsection in respect of the particular trust. A qualifying beneficiary in this circumstance may also include that particular person's Canadian-resident spouse or common-law partner and a Canadian-resident trust to which the particular person is eligible to transfer property as described in section 73.

Paragraph 107(4.1)(d) provides that the final condition for the application of subsection 107(4.1) is that the specified person described in subparagraph 107(4.1)(c)(i) must be in existence at the time the property was distributed. Paragraph 107(4.1)(d) is amended, consequential on the amendment to paragraph 107(4.1)(c), to provide that the specified person or particular person described in subparagraph 107(4.1)(c)(i) or (ii), as the case may be, must be in existence at the time the property was distributed in order for subsection 107(4.1) to apply.

For further information, see the commentary on subsections 94(8.1) and (8.2).

These amendments apply to taxation years that end after March 20, 2013.

Clause 29

Ceasing to be a qualifying environmental trust

ITA 107.3

Section 107.3 of the Act sets out a number of rules dealing with the taxation of the beneficiaries of a qualifying environmental trust (as defined in subsection 248(1)).

ITA

107.3(3)

Subsection 107.3(3) of the Act sets out a number of the tax consequences that apply if a trust ceases to be a qualifying environmental trust (QET) at any time: under paragraph 107.3(3)(a), the trust's taxation year is deemed to have ended (with the result that Part XII.4 of the Act will apply to the trust for that taxation year), and under paragraph 107.3(3)(b) the trust is deemed to have disposed of each of its properties at their fair market value immediately before that time and to have required each such property immediately after that time at a cost equal to those proceeds.

Consequential on an amendment to extend subsection 149(10) to trusts, paragraphs 107.3(3)(a) and (b) are replaced by new paragraph 107.3(3)(a), which deems a trust to cease to be exempt from tax under Part I of the Act at the time at which the trust ceases to be a QET. Under subsection 149(10), such trusts continue to be subject to a deemed year-end and a deemed disposition of property. Subsection 107.3(3) also continues to apply on a loss of QET status at any time whether the trust remains exempt from tax under subsection 149(1) at that time or not. For further information, see the commentary on subsection 149(10).

Paragraphs 107.3(3)(c) and (d) are, as a consequence of this amendment, renumbered as paragraphs 107.3(3)(b) and (c).

These amendments come into force on March 21, 2013.

Clause 30**Lifetime capital gains exemption**

ITA

110.6(2), (31) and (32)

The formula in paragraph 110.6(2)(a) of the Act provides a lifetime limit for the total amount of capital gains deductions that an individual may claim in respect of qualified farm property (and by virtue of subsections 110.6(2.1) and (2.2) in respect of qualified small business corporation shares and qualified fishing property). Paragraph 110.6(2)(a) is amended to increase the limit from \$375,000 to \$400,000, effective for the 2014 taxation year. This amount will be indexed to the Consumer Price Index (CPI) for the 2015 and subsequent taxation years. For further information, see the commentary on subsection 117.1(1).

Subsections 110.6(31) and (32) restrict the amount of lifetime capital gains exemption (LCGE) that can be claimed for a taxation year in respect of a capital gains reserve included in income in the year that is attributable to a property disposed of before March 19, 2007. These subsections are intended to prevent an individual from claiming a capital gains deduction for a taxation year beginning after March 19, 2007 (i.e., when the LCGE is \$375,000) in respect of such a reserve, except to the extent that the individual could have claimed an additional deduction for the taxation year in which the disposition occurred without exceeding the LCGE of \$250,000 (as it was for taxation years that began before March 20, 2007) if the individual had not claimed a reserve in that earlier year. An individual should not benefit from the increase to the LCGE (from \$250,000 to \$375,000) by claiming a capital gains reserve under paragraph 40(1)(a)(iii) in the year of the disposition of a property.

As a result of indexing, the LCGE will now increase along with increases in the CPI. Subsections 110.6(31) and (32) are replaced with new subsection 110.6(31) to provide that, for a disposition of property that is eligible for a capital gains deduction for the taxation year of disposition, a deduction

for a future year is not available in respect of the disposition except to the extent of the LCGE for the taxation year of the disposition.

This amendment applies in respect of dispositions in taxation years beginning after March 19, 2007, the date on which the LCGE increased from \$250,000 to \$375,000.

In particular, new subsection 110.6(31) may apply for a taxation year for which an individual includes in income all or part of a prior year reserve. The capital gains deduction otherwise deductible is reduced by the difference between the amount the individual would be able to deduct for the year without reference to subsection 110.6(31) and the amount the individual would have been able to deduct in the year if he or she had not claimed any capital gains reserves in prior years and had for those years deducted all amounts that would have been deductible under section 110.6.

Example 1

In 2013, Ben has a taxable capital gain of \$50,000 from a disposition of qualified farm property. At the time, Ben has already used \$350,000 of the existing \$375,000 LCGE limit. As a result of unpaid balance of proceeds of disposition, he claims a reserve of \$25,000 under subparagraph 40(1)(a)(iii) for 2013 and includes the remaining \$25,000 in income. Ben also claims a \$25,000 capital gains deduction.

For 2014, Ben includes the \$25,000 capital gains reserve carried forward from 2013 in income, and does not claim a new reserve. Because of the \$400,000 LCGE limit for 2014, Ben would, absent subsection 110.6(31), be able to claim a \$25,000 capital gains deduction to offset the income inclusion. However, the potential \$25,000 capital gains deduction is reduced by the amount determined by the formula $(A - B)$ in subsection 110.6(31) where:

A is the total of all amounts each of which is an amount deductible as a capital gains deduction for the year or a preceding taxation year, computed without reference to this rule. This amount is \$400,000. Ben deducted a total of \$375,000 for taxation years before 2014, and had another \$25,000 available for the 2014 taxation year.

B is the total of amounts that would have been deductible as capital gains deductions for the year or a preceding taxation year if the individual

- had not, for any preceding taxation year, claimed a capital gains reserve, and*
- had claimed, for each preceding taxation year, the capital gains deduction that would have been deductible.*

This amount is \$375,000. If Ben had not claimed a \$25,000 reserve for 2013, there would be no taxable capital gain to apply against the increased LCGE limit of \$400,000.

Ben's available capital gains deduction is reduced by $\$400,000 - \$375,000 = \$25,000$. Therefore, the capital gains deduction that Ben can claim for 2014 is nil (i.e., the capital gains deduction otherwise available of \$25,000 less the amount determined under subsection 110.6(31) of \$25,000).

Example 2

In 2014, Robert disposes of qualified farm property and has a taxable capital gain of \$75,000. Robert has previously used \$335,000 of the \$400,000 LCGE limit. As a result of unpaid proceeds of disposition, he claims a reserve of \$50,000 under subparagraph 40(1)(a)(iii) for 2014 and includes the remaining \$25,000 in income. As a consequence, Robert claims a \$25,000 capital gains deduction for the year. For 2015, Robert claims a reserve of \$25,000 under subparagraph 40(a)(iii) and includes \$25,000 in income. Also in 2015, Robert has a \$20,000 taxable capital gain from another disposition of qualified farm property – no reserve is claimed in respect of that other disposition. For 2016, the prior year's reserve of \$25,000 is included in income.

Assume that increases in the CPI increase the LCGE limit by \$10,000 in each of 2015 and 2016 (i.e., to \$410,000 and \$420,000, respectively).

Robert's total taxable capital gains for 2015 from qualified farm property is \$45,000 (i.e., \$25,000 + \$20,000). Absent the application of subsection 110.6(31), he could take a capital gains deduction in respect of the \$45,000 because the LCGE limit for 2015 of \$410,000 exceeds Robert's previously claimed capital gains deductions (i.e., \$335,000 + \$25,000 = \$360,000) by more than \$45,000.

The capital gains deduction available will be reduced by the amount determined by the formula (A - B) in subsection 110.6(31). In this case,

A = \$405,000. This is the total of \$360,000 in capital gains deductions claimed for prior years and the \$45,000 capital gains deduction claimed for 2015.

B = \$410,000. If Robert had not claimed a reserve for 2014, he could claim a capital gains deduction of \$65,000 (i.e., up to the LCGE limit of \$400,000). Then, for 2015 he could claim a \$10,000 capital gains deduction in respect of the \$20,000 taxable capital gain in that year (i.e., up to the LCGE limit of \$410,000 for 2015).

A - B is a negative number (-\$5,000) and section 257 applies to deem the amount determined by the formula to be nil. Therefore, there is no reduction to the \$45,000 capital gains deduction that may be claimed by Robert for 2015.

For 2016, Robert includes the prior year's reserve of \$25,000 in income. Robert's LCGE limit is increased to \$420,000 for 2016. Of this amount, he has claimed \$405,000 in capital gains deductions in prior years (i.e., \$335,000 + \$25,000 + \$45,000 = \$405,000).

But for the application of subsection 110.6(31), Robert would be able to claim for 2016 a capital gains deduction of \$15,000 (i.e., \$420,000 - \$405,000). This is reduced by the amount determined by the formula (A - B) in subsection 110.6(31). For this year,

A = \$420,000, the total of amounts deductible for current and prior years (if subsection 110.6(31) did not apply), which is the amount claimed up to 2015 plus the capital gains deduction available for 2016 of \$15,000.

B = \$410,000. If Robert had not claimed a capital gains reserve for any year and had claimed the full capital gains deduction available in respect of each disposition, his 2014 taxable

capital gain would have been \$75,000 and his capital gains deduction would be \$65,000 (i.e., up to the LCGE limit for 2014 of \$400,000). For 2015, he would have no reserve to include in income and would have a \$10,000 capital gains deduction (i.e., up to the LCGE limit for 2015 of \$410,000) in respect of his taxable capital gain of \$20,000 in the year. There would be no reserve included income for 2016, so there would be no capital gains deduction for the year.

$A - B = \$10,000.$

As a result, the maximum capital gains deduction Robert could claim for 2016 is \$5,000 (i.e., \$15,000 less the \$10,000 determined under subsection 110.6(31)). Subsection 110.6(31) prevents Robert from taking advantage of an increase in the LCGE limit for a year subsequent to the year in which the relevant disposition took place – in this instance, the increase in the LCGE limit from \$410,000 for 2015 to \$420,000 for 2016.

Clause 31

Loss restriction event – losses

ITA

111

Section 111 of the Act provides rules relating to the treatment of losses, and in particular establishes the extent to which a taxpayer is permitted to deduct, in computing taxable income for a taxation year, losses of other years.

ITA

111(4) to (5.3) and (5.5)

Subsections 111(4) to (5.3) and (5.5) of the Act apply to constrain a corporation's ability to deduct, in computing taxable income for a taxation year, losses of other years if there has been an intervening acquisition of control of the corporation. For example, under subsection 111(4), a corporation that undergoes an acquisition of control is required to recognize, for income tax purposes, all of its accrued capital losses on property that the corporation owns at that time. Those newly-realized capital losses, together with the corporation's existing net capital losses, cannot be used after the acquisition of control. The corporation can, however, elect to realize any accrued capital gains on other property that the corporation owns, allowing it to use some or all of its capital losses to offset those capital gains.

Subsections 111(4) to (5.3) and (5.5) are amended to extend their application to trusts. Specifically, those subsections, as amended, apply if a taxpayer that is a corporation or trust is subject to a loss restriction event. An existing rule that suspends some of the rules in those subsections if at the time of the loss restriction event the taxpayer ceases to be, or becomes, exempt from tax, is preserved, but moved to new paragraph 111(5.5)(a). For further information, see the commentary on section 251.2.

These amendments come into force on March 21, 2013.

ITA

111(8)

Subsection 111(8) of the Act defines a number of terms for purposes of section 111.

“net capital loss”

The definition “net capital loss” computes the amount of a capital loss not used in the year in which the loss was recognized that can be carried over for use in another taxation year. Net capital losses may be carried forward indefinitely. Certain capital losses realized on the sale of shares or other securities of a small business corporation are treated separately as allowable business investment losses (ABILs). ABILs that cannot be deducted in the 20-year carry-forward period for non-capital losses may generally be carried forward, on the expiry of that period, indefinitely as net capital losses. However, if the taxpayer is a corporation the control of which is acquired during the carry-forward period for non-capital losses, the loss cannot be included in the corporation’s net capital loss (i.e., paragraph (c) of variable C of the formula in the definition applies to reduce to nil the amount determined under the variable).

Paragraph (c) in the description of C of the definition “net capital loss” is amended to extend its application to trusts. Specifically, the rule now applies to a corporation or trust that is subject to a loss restriction event. For further information, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

ITA

111(12)

Subsection 111(12) of the Act extends the general treatment of accrued capital gains and losses on an acquisition of control of a corporation to a corporation’s accrued capital gains and capital losses resulting from foreign currency fluctuations on debt liabilities denominated in a foreign currency. These rules apply only to foreign currency debts the repayment of which would have generated a capital loss or gain. Subsection 111(12) provides that for the purposes of subsection 111(4), if at any time a corporation owes a foreign currency debt, the corporation is deemed to own, immediately before that time, a property with an adjusted cost base and fair market value determined by the formulas contained in paragraphs 111(12)(a) and (b), respectively.

Subsection 111(12) is amended to extend its application to trusts, consequential on the extension of subsection 111(4) to trusts. For further information, see the commentary on sections 111 and 251.2.

This amendment comes into force on March 21, 2013.

Clause 32

Synthetic disposition – holding period

ITA

112(8) and (9)

Subsections 112(3) to 112(7) provide “stop-loss” rules that reduce, in certain cases, the amount of a loss otherwise realized by a corporation on a disposition of shares by the amount of tax-free dividends received by the corporation on the shares. These stop-loss rules are subject to exceptions that apply depending on whether the corporate shareholder holds the share as a capital property, an income property or a mark-to-market property. For certain of these exceptions to apply, the shares must be held throughout the 365-day period that ends immediately before their disposition. These exceptions are contained in paragraphs 112(3.01)(b) and (3.11)(b), subclauses (3.2)(a)(ii)(C)(I) and (3.3)(a)(ii)(C)(I) and paragraphs (3.31)(b), (3.32)(b), (4.01)(b), (4.11)(b), (4.21)(b), (4.22)(b), (5.1)(b) and (5.21)(b).

New subsection 112(8) is added to ensure that taxpayers cannot circumvent the application of the stop-loss rules by entering into a synthetic disposition arrangement in order to meet the 365-day ownership requirement. Subsection 112(8) provides that, if a synthetic disposition arrangement is entered into in respect of a property owned by a taxpayer and the synthetic disposition period in respect of the synthetic disposition arrangement is 30 days or more, then for the purposes of the listed exceptions to the stop-loss rules, the taxpayer is deemed not to own the property during the synthetic disposition period. As a consequence, unless the taxpayer continues to own the property for more than one year after the end of the synthetic disposition period, the 365-day test in the exceptions will generally not be met. The new terms “synthetic disposition arrangement” and “synthetic disposition period” are defined in subsection 248(1).

New subsection 112(9) provides that subsection 112(8) does not apply to a taxpayer in respect of a property owned by a taxpayer in respect of a synthetic disposition arrangement if the taxpayer owned the property throughout the 365-day period that ended immediately before the synthetic disposition period in respect of the synthetic disposition arrangement. In determining whether a taxpayer owned the property throughout the 365-day period, the taxpayer will not be considered to own the property throughout that period if subsection 112(8) previously applied in respect of the property during that period or would have previously applied if the determination in subsection 112(8) were made without reference to subsection 112(9). This ensures that subsection 112(8) applies only where a synthetic disposition arrangement is used to allow a taxpayer to meet a 365-day hold period test that the taxpayer otherwise would not have met.

Subsections 112(8) and (9) apply to agreements and arrangements entered into after March 20, 2013. They also apply to an agreement or arrangement entered into before March 21, 2013, the term of which is extended after March 20, 2013, and they apply to the agreement or arrangement as if the agreement or arrangement were entered into at the time of the extension.

Clause 33

Annual adjustment

ITA

117.1(1)

Subsection 117.1(1) of the Act provides for the indexing of various amounts in the Act, based on annual increases to the Consumer Price Index. Subsection 117.1(1) is amended to extend its application to the reference to the amount of \$400,000 in the formula in paragraph 110.6(2)(a) (the lifetime capital gains exemption limit).

This amendment applies to the 2015 and subsequent taxation years.

Clause 34

Definitions

ITA

123.4(1)

“full rate taxable income”

Section 123.4 of the Act contains rules that allow a corporation to reduce its tax otherwise payable under Part I of the Act by a percentage of its full rate taxable income. The full rate taxable income of a corporation for a taxation year is, in general terms, that part of the corporation’s taxable income for the

year that is not exempt from tax and has not benefited from any of the various special effective tax rates provided under the Act. This amount is determined differently depending on the status of the corporation.

Subparagraph (a)(iv) of the definition “full rate taxable income” excludes from the full rate taxable income of a corporation that was a credit union throughout a taxation year the corporation’s taxable income that was subject in the year to the additional deduction from tax otherwise payable available to credit unions under subsection 137(3).

Subparagraph (a)(iv) is amended to replace the reference to the amount determined for variable B in the formula in subsection 137(3) with a reference to the amount obtained when the amount determined for variable B in that formula is multiplied by the amount determined for variable C in that formula. This amendment is consequential on the phase-out for the additional deduction available to credit unions in subsection 137(3) contained in the *Economic Action Plan 2013 Act, No. 1*, S.C. 2013, c.33 and is made to ensure that the taxable income of a credit union that does not benefit from the additional deduction is not precluded, because of subparagraph (a)(iv), from benefitting from the general rate reduction in subsection 123.4(2).

This amendment applies to taxation years that end after March 20, 2013.

Clause 35

Synthetic disposition – holding period

ITA

126(4.5) and (4.6)

Section 126 of the Act provides rules under which a taxpayer may deduct, from tax otherwise payable, amounts that have been paid in respect of foreign tax.

Subsection 126(4.2) limits the foreign tax credit in respect of dividends or interest on a share or debt obligation held by the taxpayer for one year or less. Where it applies, subsection 126(4.2) limits the foreign tax credit to the amount of Canadian tax that would be payable at a notional rate on the gross income from a foreign country in which the tax was paid. Subsection 126(4.2) applies to arrangements where a person, who is subject to a foreign withholding tax on a particular source of income but is unable to obtain a foreign tax credit, effectively transfers that income to another person who is able to use the tax credit against Canadian tax on income from other sources in that foreign country.

New subsection 126(4.5) is introduced to ensure that a taxpayer cannot circumvent the application of subsection 126(4.2) by entering into a synthetic disposition arrangement that allows the taxpayer to legally own a property for a period of more than one year while not having any substantial risk of loss or opportunity for gain or profit in respect of the property during the period.

Subsection 126(4.5) provides that, if a synthetic disposition arrangement is entered into in respect of a property owned by a taxpayer and the synthetic disposition period in respect of the synthetic disposition arrangement is at least 30 days, for the purpose of determining whether the period referred to in subsection 126(4.2) is at least one year, the period is deemed to begin at the earlier of

- the time that is immediately before the particular time (i.e., the time at which the taxpayer disposes of the property) referred to in subsection 126(4.2), and
- the end, if any, of the synthetic disposition period.

As a consequence, unless the taxpayer continues to own the property for at least one year after the end of the synthetic disposition period, the one-year test in 126(4.2) will not generally be met.

The new terms “synthetic disposition arrangement” and “synthetic disposition period” are defined in subsection 248(1).

New subsection 126(4.6) generally provides that subsection 126(4.5) does not apply to a taxpayer in respect of a property owned by a taxpayer in respect of a synthetic disposition arrangement if the taxpayer owned the property throughout the one-year period that ended immediately before the synthetic disposition period of the synthetic disposition arrangement. In determining whether a taxpayer owned the property throughout the one-year period, the taxpayer will not be considered to own the property throughout that period if subsection 126(4.5) applied in respect of the property during that period or would have applied if the determination in subsection 126(4.5) were made without reference to subsection 126(4.6). This ensures that subsection 126(4.5) applies only where a synthetic disposition arrangement is used to allow a taxpayer to meet a one-year hold period test that the taxpayer otherwise would not have met.

New subsections 126(4.5) and (4.6) apply to agreements and arrangements entered into after March 20, 2013. They also apply to an agreement or arrangement entered into before March 21, 2013, the term of which is extended after March 20, 2013, and they apply to the agreement or arrangement as if the agreement or arrangement were entered into at the time of the extension.

Clause 36

Deductions from Part I tax

ITA
127

Section 127 of the Act allows a taxpayer to take certain deductions in computing tax payable for logging taxes, political contributions and investment tax credits.

Loss restriction event

ITA
127(9), (9.1) and (9.2)

“investment tax credit”

Subsection 127(5) of the Act provides for the deduction of investment tax credit (ITCs) from a taxpayer’s Part I tax otherwise payable. The term “investment tax credit” is defined in subsection 127(9). The definition provides for the calculation of a taxpayer’s ITCs at the end of a taxation year and allows ITCs for a year to be carried over, with certain limits, to other years. The definition also ensures that a tax credit is not generated in circumstances where the business income to which a cost or expenditure relates is not subject to income tax. Paragraphs (j) and (k) of the definition restrict the carryover of unused ITCs by a corporation after control of the corporation is acquired. Specifically, paragraphs (j) and (k) reduce a corporation’s ITC by the amounts determined under subsections 127(9.1) and 127(9.2).

Subsection 127(9.1) sets out the rules for determining the amount by which a corporation’s carry-forward of unused ITCs earned before an acquisition of control is limited, under paragraph (j) of the definition of “investment tax credit”, for claims against taxes payable in respect of income earned after the acquisition of control. Subsection 127(9.2) sets out the rules for determining the amount by which

a corporation's carry-back of unused ITCs earned after an acquisition of control is limited, under paragraph (k) of the definition of "investment tax credit", for claims made against taxes payable in respect of income earned before the acquisition of control. The general effect of these rules is that a corporation cannot carry over amounts in respect of ITCs except to the extent of income tax arising in respect of income earned in the same or a similar business to that carried on before the acquisition of control.

Paragraphs (j) and (k) of the definition "investment tax credit" in subsection 127(9), and subsections 127(9.1) and (9.2), are amended to extend their application to trusts, by referring to a taxpayer that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

Definitions

ITA

127(9)

Subsection 127(9) of the Act provides various definitions relevant for the purpose of calculating a taxpayer's investment tax credits.

"pre-production mining expenditure"

The definition "pre-production mining expenditure" in subsection 127(9) describes the type of exploration expenses that are eligible for an investment tax credit (ITC). Generally, a pre-production mining expenditure is a grass roots exploration or pre-production development expenditure incurred in Canada in respect of qualifying minerals. These expenditures include certain expenses generally described in paragraphs (f) and (g) of the definition "Canadian exploration expense" (CEE) in subsection 66.1(6).

Subparagraph (a)(ii) of the definition "pre-production mining expenditure" is amended to add references to new paragraphs (g.3) and (g.4) of the definition of CEE, consequential on the phase-in of the transition from CEE to Canadian development expense for eligible pre-production mine development expenses incurred after March 20, 2013. This amendment ensures that CEE described in paragraphs (g.3) and (g.4) of the definition CEE will continue to earn ITCs during the phase-out of ITCs for the pre-production mining expenditures.

This amendment comes into force on March 21, 2013.

"specified percentage"

The definition "specified percentage" in subsection 127(9) sets out the relevant rates at which investment tax credits (ITCs) are earned in different circumstances.

Clause (k)(iii)(B) of the definition "specified percentage" is amended to ensure that expenditures incurred in 2015 that are described in subparagraph (a)(ii) of the definition "pre-production mining expenditure" because of new paragraph (g.4) of the definition of "Canadian exploration expense" (CEE) in subsection 66.1(6) continue to earn ITCs at the proper rate. New paragraph (g.4) of the definition of CEE reduces the percentage of the eligible CEE to 80% of what would otherwise qualify as CEE for the purposes of pre-production mining expenditures. This amendment is consequential on the amendments to the definition of CEE to phase in the transition from CEE to Canadian development expense, as defined in subsection 66.2(5).

This amendment comes into force on March 21, 2013.

Clause 37

Deduction of labour-sponsored funds tax credit

ITA

127.4(2)

Subsection 127.4(2) of the Act provides authority for the deduction of a labour sponsored-sponsored funds tax credit by an individual (other than a trust).

Subsection 127.4(2) is repealed concurrent with the phase-out of the labour sponsored-sponsored funds tax credit, effective for the 2017 and subsequent taxation years.

Labour-sponsored funds tax credit limit

ITA

127.4(5)

Subsection 127.4(5) of the Act sets out the calculation of an individual's labour-sponsored funds tax credit limit for a taxation year. The limit is the lesser of \$750 and the total of the individual's labour-sponsored funds tax credits in respect of original acquisitions (as defined in subsection 127.4(1)) in the year or in the first 60 days of the following year of approved shares, except that original acquisitions reflected in the individual's claim under subsection 127.4(2) for the preceding taxation year are ignored.

Subsection 127.4(5) is amended to phase out the labour-sponsored funds tax credit limit according to the same schedule as for the phase-out of the labour-sponsored funds tax credit. Specifically, the labour-sponsored funds tax credit limit will be reduced to \$500 for the 2015 taxation year and to \$250 for the 2016 taxation year. Subsection 127.4(5) is repealed effective for the 2017 and subsequent taxation years. Original acquisitions in the first 60 days of 2017 will continue to be eligible for the labour-sponsored funds tax credit for 2016.

Labour-sponsored funds tax credit

ITA

127.4(6)

Subsection 127.4(6) of the Act sets out the calculation of an individual's labour-sponsored funds tax credit in respect of an original acquisition (as defined in subsection 127.4(1)) of an approved share for a taxation year. This tax credit is generally equal to 15% of the net cost to the individual (or to a registered retirement savings plan or tax-free savings account of the individual) in respect of the original acquisition of the share by the individual or trust.

Subsection 127.4(6) is amended to phase out the labour-sponsored funds tax credit. Specifically, the credit will be reduced to 10% for the 2015 taxation year and to 5% for the 2016 taxation year. Subsection 127.4(6) is repealed effective for the 2017 and subsequent taxation years.

The labour-sponsored funds tax credit that applies to a given labour-sponsored funds tax credit deduction claim will be based on the taxation year that the labour sponsored funds tax credit is claimed, rather than the year in which an approved share is acquired. For instance, an original acquisition of an approved share that takes place in the first 60 days of 2015, but is claimed in respect of the 2014 taxation year, will be eligible for the 15% labour-sponsored funds tax credit.

Clause 38

Reasonable errors

ITA

147.1(19)

Section 147.1 of the Act sets out rules related to registration and administration of pension plans. New subsection 147.1(19) is added to permit administrators of registered pension plans to refund to a contributor any amount that had been contributed to the plan as result of a reasonable error, if the payment is made no later than December 31 of the year following the year in which the contribution was made.

Subsection 147.1(19) supplements an existing provision in subparagraph 8502(d)(iii) of the *Income Tax Regulations*, which permits (without a time limit) a refund of contributions in order to avoid the revocation of plan registration.

Subparagraph 56(1)(a)(i) generally requires that the amount refunded be included in the income of the recipient taxpayer (the member of the plan or the employer, as the case may be) except where new clause 56(1)(a)(i)(G) applies to exempt the amount from income inclusion (i.e., the amount is refunded under subsection 147.1(19) of the Act or subparagraph 8502(d)(iii) of the *Income Tax Regulations*, and the original contribution amount is not deducted for the taxation year in which the refund is made or for any preceding taxation year).

For further information, see the commentary on clause 56(1)(a)(i)(G). Please note that provincial standards legislation in some provinces set out conditions under which refunds of errant contributions must be approved by the provincial regulator.

This amendment applies to contributions made on or after the later of January 1, 2014 and the day on which Royal Assent is received.

Clause 39

Policy dispositions

ITA

148

Section 148 of the Act provides rules for determining the income tax consequences from a disposition of an interest in a life insurance policy.

ITA

148(5)

Under section 148 of the Act, the surrender of an interest in a life insurance policy is typically treated as a disposition. Subsection 148(1) requires a taxpayer that disposes of an interest in certain life insurance policies to include in computing the taxpayer's income for a taxation year the taxpayer's net gain in respect of the interest. The net gain is computed as the difference between the proceeds of the disposition that the taxpayer was entitled to receive in the year in respect of the disposition and the adjusted cost basis to the policyholder of the interest immediately before the disposition.

Where subsection 148(1) applies to require an amount to be included in a policyholder's income in respect of the full or partial surrender of an interest in a 10/8 policy, new subsection 148(5) applies to provide an offsetting deduction. The deduction under subsection 148(5) is available only in respect of

such a disposition that occurs in the period (the transition period) after March 20, 2013 and before 2014. The deduction is intended to alleviate the income tax consequences from a withdrawal of savings from a 10/8 policy made to repay a 10/8 borrowing or policy loan against the policy (i.e., a borrowing or policy loan described in the definition of “10/8 policy”). For further information, see the commentary on the new definition “10/8 policy” in subsection 248(1).

The maximum deduction available to the policyholder in respect of a disposition under subsection 148(5) is the least of three amounts:

- A specified portion of the amount included in the policyholder’s income for the year under subsection 148(1) in respect of the disposition. The specified portion is the amount of the gain included under subsection 148(1) that is attributable to an investment account under the policy (i.e., an investment account described in paragraph (b) of the definition “10/8 policy” in subsection 248(1) in respect of the policy);
- The amount that is the total of all payments, made in the transition period, that reduce the amount outstanding of 10/8 borrowings or policy loans in respect of the policy; and
- The amount that is the total of all amounts the policyholder is entitled to receive as a result of the disposition and that are paid during the transition period directly or indirectly out of an investment account under the policy (i.e., an investment account described in paragraph (b) of the definition “10/8 policy” in subsection 248(1) in respect of the policy).

To prevent double counting, the totals described above exclude amounts that have been included under subsection 148(5) in computing another total in respect of a deduction under that subsection by any taxpayer.

This amendment applies to taxation years that end after March 20, 2013.

Clause 40

Becoming or ceasing to be exempt

ITA

149(10)

Subsection 149(10) of the Act applies if, at a particular time, a corporation becomes or ceases to be exempt from tax under Part I of the Act on its taxable income (otherwise than by reason of the exemption for certain insurers in paragraph 149(1)(t)). Under paragraphs 149(10)(a) and (b), a new taxation year is considered to start at the particular time and the corporation’s properties are deemed to have been disposed of at fair market value and reacquired at the particular time for the same amount. Paragraph 149(10)(c) provides that the corporation is, for specified purposes in the Act, treated as a new corporation, with the effect that a number of tax attributes of the corporation cannot be carried over across the change in tax status. Paragraph 149(10)(d) requires the corporation to realize in its taxation year that includes its change in status any accrued loss in respect of its cumulative eligible capital.

Subsection 149(10) is amended to extend its application to trusts that, on or after Announcement Date, become or cease to be exempt from tax under Part I. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

Clause 41

Assessment and reassessment

ITA

152(4)

Subsection 152(4) of the Act generally provides that the Minister of National Revenue may at any time assess tax and other amounts payable by a taxpayer for a taxation year, but may not reassess after the normal reassessment period for the year. The normal reassessment period is, in general, three years from the date of the initial assessment for most taxpayers and four years for public, foreign-controlled and mutual fund corporations. Subsection 152(4) includes exceptions that apply in certain circumstances.

New paragraph 152(4)(*b.1*) is added to permit the reassessment of a participant in a tax shelter, or reportable transaction, outside of the normal reassessment period if the information return required by subsection 237.1(7) or 237.3(2) in respect of the tax shelter or reportable transaction is not filed as and when required. In these circumstances, the reassessment may be made within three years of the date that the relevant information return is filed.

New paragraph 152(5)(*b.2*) is added to permit the reassessment of a taxpayer outside of the normal reassessment period if the taxpayer has failed to report income from a specified foreign property on their annual income tax return and

- the Foreign Income Verification Statement (Form T1135) was not filed on time by the taxpayer (or by a partnership of which the taxpayer is a member), or
- a specified foreign property was not identified, or was improperly identified, on the Form T1135.

In these circumstances, the reassessment period is extended by three years.

Paragraph 152(4)(*c*) permits a reassessment outside of the normal reassessment period where a taxpayer has filed a waiver in prescribed form within the additional three-year period referred to in paragraph 152(4)(*b*). Paragraph 152(4)(*c*) is amended to also permit a reassessment outside of the normal reassessment period where the taxpayer has filed a waiver in prescribed form within the additional three-year period referred to in paragraph 152(4)(*b.1*). New paragraph 152(4)(*c.1*) permits the reassessment of a taxpayer outside of the normal reassessment period where the taxpayer has filed a waiver in prescribed form within the additional three-year period referred to in paragraph 152(4)(*b.2*).

The addition of paragraph 152(4)(*b.1*) and the reference to that paragraph in paragraph 152(4)(*c*) apply to taxation years that end after March 20, 2013.

The amendments to paragraphs 152(4)(*b.2*) and (*c.1*) apply to the 2013 and subsequent taxation years.

Assessment to which 152(4)(*a*), (*b*), (*b.1*) or (*c*) applies

ITA

152(4.01)

Subsection 152(4.01) of the Act limits the matters in respect of which the Minister of National Revenue can reassess when a reassessment to which paragraph 152(4)(*a*), (*b*) or (*c*) applies is made beyond the normal reassessment period for a taxpayer in respect of a taxation year.

Subsection 152(4.01) is amended to add references to new paragraph 152(4)(b.1), which allows for the reassessment of a participant in a tax shelter, or reportable transaction, outside of the normal reassessment period if the information return described in subsection 237.1(7) or 237.3(2) required in respect of the tax shelter or reportable transaction is not filed as and when required. As such, a reassessment of a liability for a taxation year, authorized to be made after the normal reassessment period by new paragraph 152(4)(b.1), is limited by new subparagraph 152(4.01)(b)(vii) to the deduction or claim in respect of the tax shelter or the tax benefit in respect of the reportable transaction.

This amendment applies to taxation years that end after March 20, 2013.

Where waiver revoked

ITA

152(4.1)

Where a taxpayer has filed a waiver under subparagraph 152(4)(a)(ii) of the Act, subsection 152(4.1) of the Act limits the period during which the Minister of National Revenue may reassess a liability of the taxpayer, to six months after the taxpayer has notified the Minister of the revocation of the waiver. Subsection 152(4.1) is amended to make reference to a waiver referred to in new paragraph 152(4)(c.1).

This amendment applies to the 2013 and subsequent taxation years.

Clause 42

Failure to provide claim preparer information

ITA

162(5.1) to (5.3)

New subsection 162(5.1) of the Act provides for a penalty of \$1,000 in the case of false or incomplete information disclosure of the identity of, and the terms of any arrangement with, the claim preparer of an SR&ED form. In this regard, new subsection 162(5.3) sets out that, in general, an SR&ED form is a prescribed form required to be filed under subsection 37(11), and a claim preparer is a person or partnership that agrees to accept consideration to prepare, or assist in the preparation of, the form.

In particular, subsection 162(5.1) provides that any person or partnership who makes, or participates in, assents to or acquiesces in the making of, a false statement or omission in respect of claim preparer information required to be included in a form, that is required to be filed under subsection 37(11), is jointly and severally, or solidarily, liable with any claim preparer, who agrees to accept consideration to prepare, or assist in the preparation of, the form, to a penalty of \$1,000.

Subsection 162(5.3) provides that a “claim preparer” is a person or partnership who agrees to accept consideration to prepare, or assist in the preparation of, an SR&ED form. An employee who prepares, or assists in the preparation of, an SR&ED form in the course of performing their employment duties is not a claim preparer. “Claim preparer information” is generally any prescribed information to be included in an SR&ED form regarding the identity of any claim preparer, and the arrangement under which the claim preparer agrees to accept consideration in respect of preparing, or assisting in the preparation of, the form.

New subsection 162(5.2) provides that a claim preparer will not be liable to the penalty if it is determined that the claim preparer has exercised the degree of care, diligence and skill to prevent the

making of the false statement or omission that a reasonably prudent person would have exercised in comparable circumstances. This is commonly referred to as a “due diligence” defence. Whether a person has exercised the degree of care, diligence and skill required will be based on the facts and circumstances of each case. It is intended that the application of the due diligence defence for the purposes of subsection 162(5.1) be based on jurisprudence that applies in respect of similar defences for the purposes of other provisions of the Act.

These amendments apply to forms filed on or after the later of January 1, 2014 and the day on which these subsections receive Royal Assent.

Clause 43

Electronic suppression of sales penalties

ITA

163.3

New section 163.3 of the Act provides for administrative monetary penalties in relation to electronic suppression of sales software or devices (ESS software) that are, or are intended to be, capable of being used in relation to records that are required to be kept under section 230 of the Act. These new penalties are in addition to other penalties that may be assessed under the Act.

New subsection 163.3(1) defines the terms “electronic cash register”, “electronic suppression of sales device” and “service” for the purposes of section 163.3.

- “Electronic cash register” generally means an electronic device or computer system designed to record transaction data, or any other electronic point-of-sale system.
- “Electronic suppression of sales device” generally means a software program that falsifies the records of electronic cash registers or a hidden programming option in an electronic cash register that may be used to create a virtual second till or to, eliminate or manipulate transaction records in the electronic cash register.
- “Service” has the meaning assigned by subsection 123(1) of the *Excise Tax Act*. This term has, generally, a broad meaning covering anything other than property, money and a supply of services rendered by an employee to an employer.

New subsection 163.3(2) imposes a penalty on every person that uses ESS software or that under circumstances attributable to neglect, carelessness or wilful default, participates in, assents to or acquiesces in the use of ESS software. New subsection 163.3(3) imposes a penalty on every person that acquires or possesses ESS software or a right in respect of ESS software. Section 285.01 of the *Excise Tax Act* imposes similar penalties. On the first assessment of either penalty, under the Act or the *Excise Tax Act*, the amount of the penalty under subsection 163.3(2) or (3) is \$5,000. If the person has already been assessed a penalty in relation to ESS software under either Act, the penalty for any subsequent use, acquisition or possession by the person of ESS software is \$50,000.

New subsection 163.3(4) imposes a penalty on every person that designs, develops, manufactures, sells, possesses for sale, offers for sale, or otherwise makes available ESS software. Section 285.01 of the *Excise Tax Act* imposes a similar penalty. On the first assessment of a penalty, under the Act or the *Excise Tax Act*, the amount of the penalty is \$10,000. If the person has already been assessed a penalty in relation to the manufacturing or making available of ESS software under either Act, the amount of the penalty is \$100,000. If it is the first assessment of a penalty in relation to the manufacturing or

making available of ESS software, but another penalty in relation to the use, acquisition or possession of ESS software has previously been imposed under either Act, the amount of the penalty is \$50,000.

New subsection 163.3(5) clarifies the limitations that apply with respect to the assessment of multiple penalties under subsections 163.3(2) to (4). This subsection provides that if the Minister assesses a penalty under subsections 163.3(2) to (4), the Minister is not to assess another penalty in respect of an action that relates to ESS software that occurred before that penalty was assessed.

New subsection 163.3(6) provides that, unless specifically provided by new subsection 163.3(7), a due diligence defence is not available in relation to penalties imposed under subsection 163.3(2) to (4).

New subsection 163.3(7) provides that, in the case of penalties imposed under new subsections 163.3(3) and (4), a person is not liable in respect of an action of the person if the person exercised the degree of care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances to prevent that action from occurring.

New subsection 163.3(8) provides that, for the purpose of applying new subsections 163.3(2) to (7), if an assessment of a penalty under subsections 163.3(2) to (4) is vacated, the penalty is deemed to have never been assessed. This would mean, for example, that if an assessment of a penalty is vacated, that assessment would no longer trigger the limitation provided for in new subsection 163.3(5).

New section 163.3 comes into force on the later of the day on which the section receives Royal Assent and January 1, 2014.

Clause 44

Conditions for registration

ITA

204.81(1)

Section 204.81 of the Act sets out the conditions for the registration of labour-sponsored venture capital corporations (LSVCCs). Subsection 204.81(1) permits the Minister of National Revenue to register a corporation as an LSVCC under Part X.3 of the Act if its articles satisfy specified conditions and certain other requirements are met. Concurrent with the phase-out of the labour-sponsored funds tax credit, subsection 204.81(1) is amended to prevent the new registration of an LSVCC if the application for registration was received by the Minister after March 20, 2013.

Clause 45

“labour-sponsored funds tax credit”

ITA

211.7(1)

Subsection 211.7(1) of the Act provides definitions for the purposes of Part XII.5 of the Act. “Labour-sponsored funds tax credit” in respect of a share is defined as:

- if the original acquisition of the share occurred before 1996, 20% of the net cost of the share on that acquisition, and
- in any other case, the federal tax credit potentially available in respect of the acquisition of the share, ignoring the consideration limits set out in subsection 127.4(5).

For labour-sponsored venture capital corporations registered under Part X.3 of the Act, Part XII.5 levies a tax on the disposition of a share, which is essentially a recovery of the labour-sponsored funds tax credit in respect of the original acquisition of the share.

The definition “labour-sponsored funds tax credit” is amended consequential on the phase-out of the credit, in order to ensure that the appropriate penalty is applied to shares under Part XII.5 for years of acquisition where the labour-sponsored funds tax credit had been reduced, and to eliminate the penalty for years where the acquisition of the share did not benefit from the tax credit.

Specifically, paragraph (b) of the definition is amended for original acquisitions of shares after 1995 and prior to March 2, 2017, to calculate the tax credit as the federal tax credit potentially available in respect of the acquisition of the share based on the claim by the individual under subsection 127.4(2) in respect of the original acquisition of the share. New paragraph (c) is added to ensure that acquisitions on or after March 2, 2017 will result in a labour-sponsored funds tax credit of nil for the purposes of Part XII.5.

The amendment is deemed to have come into force on March 21, 2013.

Clause 46

Tax for failure to re-acquire certain shares

ITA

211.81

Section 211.81 of the Act provides for a matching federal tax when an individual is liable to pay a provincial tax, prescribed by regulation, in respect of an approved share of a labour-sponsored venture capital corporation (LSVCC). In this regard section 6709 of the *Income Tax Regulations* prescribes, for the purposes of section 211.81, the tax payable under Quebec’s *Taxation Act* for an individual who fails to acquire a new approved share of an LSVCC, after the individual has disposed of another approved share of an LSVCC for the purpose of investing the proceeds in a home buyers plan or a lifelong learning plan. The existing penalty under section 211.81 matches the penalty applicable under Quebec’s *Taxation Act*.

The federal penalty is amended so that it is equal to the federal tax credit that the individual received on the acquisition of the share.

This amendment comes into force on October 24, 2012, the time when the provision was first enacted.

Clause 47

Non-arm’s length share sale by non-resident

ITA

212.1

Section 212.1 of the Act is an anti-avoidance rule designed to prevent the removal of taxable corporate surplus as a tax-free return of capital through a non-arm’s length transfer by a non-resident of shares from one Canadian corporation to another Canadian corporation.

The references in the English version of section 212.1 to the term “majority interest partner” and “majority interest group of partners” are replaced with references to “majority-interest partner” and “majority-interest group of partners”. These amendments are consequential on a similar amendment to

the definition “majority-interest partner” in subsection 248(1). For further information, see the commentary on that definition.

These amendments come into force on Royal Assent.

Clause 48

Penalty on conviction

ITA

239(3)

Subsection 239(3) of the Act provides that if a person is convicted of an offence under section 239, the person will not after that time be subject to a penalty under any of sections 162, 163 and 163.2 for the same action that led to the conviction. This subsection is amended to also apply to a person who would otherwise be subject to a penalty under new section 163.3.

This amendment comes into force on the later of the day on which the amendment receives Royal Assent and January 1, 2014.

Clause 49

Electronic suppression of sales – offences

ITA

239.1

New section 239.1 of the Act sets out offences in relation to electronic suppression of sales software or devices (ESS software) that are, or are intended to be, capable of being used in relation to records that are required to be kept under section 230 of the Act.

New subsection 239.1(1) provides that the definitions in subsection 163.3(1) of the Act apply in section 239.1. For more information, refer to the commentary for subsection 163.3(1).

New subsection 239.1(2) provides that every person is guilty of an offence if that person, without lawful excuse, the proof of which lies on the person,

- (a) uses an electronic suppression of sales device (as defined in new subsection 163.3(1)) or a similar device or software in relation to records that are required to be kept under section 230,
- (b) acquires or possesses an electronic suppression of sales device, or a right in respect of an electronic suppression of sales device, that is, or is intended to be, capable of being used in relation to records that are required to be kept under section 230,
- (c) designs, develops, manufactures, possesses for sale, offers for sale, sells, transfers, or otherwise makes available to another person, an electronic suppression of sales device that is, or is intended to be, capable of being used in relation to records that are required to be kept under section 230,
- (d) supplies installation, upgrade or maintenance services for an electronic suppression of sales device that is, or is intended to be, capable of being used in relation to records that are required to be kept under section 230, or
- (e) participates in, assents to or acquiesces in the commission of, or conspires with any person to commit any of the foregoing.

In addition to any penalty otherwise provided, the person is liable on summary conviction, to a fine of not less than \$10,000 and not more than \$500,000, or to imprisonment for a term not exceeding two years, or to both.

New subsection 239.1(3) provides that, in respect of the offences described in subsection 239.1(2), the Attorney General of Canada may proceed by indictment. If convicted, the person is liable to a fine of not less than \$50,000 and not more than \$1,000,000, or to imprisonment for up to five years, or to both.

New subsection 239.1(4) provides that if a person is convicted of an offence under section 239.1, the person will not be liable to pay a penalty under any of sections 162, 163, 163.2 and 163.3 of the Act for the same action that led to the conviction. This general rule will not apply, however, if a notice of assessment in respect of the penalty was issued before the information or complaint giving rise to the conviction was laid or made.

New subsection 239.1(5) provides that the Minister may file with the Tax Court of Canada a stay of proceedings for an appeal under the Act of an assessment, pending the determination of a prosecution under section 239.1, where substantially the same facts are at issue in both instances.

New section 239.1 comes into force on the later of the day on which the section receives Royal Assent and January 1, 2014.

Clause 50

Definitions

Subsection 248(1) of the Act provides a number of definitions that apply for the purposes of the Act.

ITA

248(1)

“derivative forward agreement”

The definition “derivative forward agreement” is added to subsection 248(1). A derivative forward agreement essentially combines a derivative financial instrument with the purchase or sale of an otherwise unrelated capital property. Income from derivative investments is generally fully taxable as ordinary income. Derivative forward agreements are typically used in an attempt to convert this fully taxable derivative income to a capital gain, only half of which is included in income. A derivative forward agreement therefore involves the purchase or sale of a capital property.

Paragraph (a) of the definition requires that the term of the agreement exceed 180 days or the agreement be part of a series of agreements with a term that exceeds 180 days. For example, a series of seven 30-day “rolling” forward agreements, where a new agreement is entered into as soon as its predecessor concludes, would have a term that exceeds 180 days. In contrast, two agreements that each have a term of 100 days and operate concurrently (i.e., they have the same start and end dates) would not have a term that exceeds 180 days, even if they are part of the same series.

Purchase Agreements

Paragraph (b) of the definition deals with agreements to purchase a capital property. In order for a purchase agreement to be a derivative forward agreement, the economic return on the agreement must have a derivative component. The economic return under such a purchase agreement is the difference between the price paid for the property and the fair market value of the property when it is delivered. If the agreement is a derivative forward agreement, this return will be included (or potentially

deducted if there is a loss) in computing the taxpayer's income under paragraph 12(1)(z.7) (or paragraph 20(1)(xx)).

For the purpose of determining whether the return has a derivative component, the return must be attributable, in whole or in part, to an underlying interest that is not described in subparagraph (b)(i) or (ii). The term "underlying interest" is intended to have a broad meaning and it includes a value, price, rate, variable, index, event, probability or thing. For example, the return could be based on the value of a reference fund, 1.5 times the return on the TSX over a period of time, LIBOR, an express or implied fixed interest rate or the price of a commodity.

Subparagraphs (b)(i) and (ii) of the definition excludes certain underlying interests. Subparagraph (b)(i) essentially provides that, where the economic return on the purchase of a property is based on the economic performance of the property being purchased, the purchase agreement will not be a derivative forward agreement. Subparagraph (b)(ii) ensures that, where the purchase price of the property is denominated in a foreign currency, changes in the value of the Canadian currency relative to the foreign currency will not cause the purchase agreement to be a derivative forward agreement.

Sale Agreements

Paragraph (c) of the definition deals with agreements to sell a capital property. The determination of whether a sale agreement meets the conditions in paragraph (c) involves two steps:

- (i) Is there a derivative component to the agreement?
- (ii) If so, is the taxpayer's economic exposure primarily based on the property being sold?

Subparagraph (c)(i) tests whether the taxpayer's economic return has a derivative component. The return on a sale agreement is the difference between the fair market value of the property at the time the agreement is entered into and the sale price of the property. As with purchase agreements, a sale agreement will not be a derivative forward agreement where the economic return under the agreement is attributable to the economic return on the property being sold. Where the sale price of the property is denominated in a foreign currency, changes in the value of the Canadian currency relative to the foreign currency will not cause the sale agreement to be a derivative forward agreement.

Since the economic return under the agreement is based upon the difference between the fair market value of the property at the time the agreement is entered into and the sale price of the property, payments under the agreement that relate to the fair market value of the property at the time the agreement is entered into are not included in determining the economic return. For example, that may be the case where the parties to a transaction agree to defer the determination and payment of the portion of the purchase price that is based on a hard to value asset (e.g., goodwill).

Subparagraph (c)(ii) provides that an agreement will not be a derivative forward agreement where the taxpayer retains a substantial level of economic exposure to the property being sold. An agreement will not be a derivative forward agreement unless the agreement is part of an arrangement that has the effect of eliminating a majority of the taxpayer's opportunity for profit and risk of loss in respect of the property for a period of more than 180 days (a deeming rule applies where such agreements are entered into by non-arm's length persons). This ensures that the derivative forward agreement rules will not apply where the taxpayer's economic exposure is still based primarily on the property being sold, even if there is a derivative component to the sale agreement.

For further information on the elimination of risk of loss and opportunity for gain or profit, see the commentary under the definition "synthetic disposition arrangement" in subsection 248(1).

Example – Put/Calls

A taxpayer has a property worth \$100. If the taxpayer writes a covered call option that allows the option holder to acquire the property for \$105 in a year, the taxpayer would retain an economic exposure to \$5 of upside and all of the downside in respect of the property. Where the property is sold on the exercise of the call option, the agreement would not be a derivative forward agreement.

On the other hand, if the taxpayer writes the same covered call option and acquires a put option that allows it to sell the property in a year for \$105, the taxpayer would have eliminated their economic exposure to the property (if the value of the property exceeds \$105 in a year, the call option holder would be expected to exercise the call option and purchase the property for \$105 and if the value of the property is less than \$105 in a year, the taxpayer would exercise the put option and sell the property for \$105). Where the property is sold on the exercise of either the put option or the call option, the relevant agreement would be a derivative forward agreement.

Example – Exchangeable Shares

A taxpayer owns 100 shares of Yco, a Canadian corporation. The terms of the Yco shares contain a right to redeem the shares (along with a limited right for Yco to retract) at any time in exchange for shares of Zco, a publicly traded foreign corporation, or an amount of cash determined by reference to the value of the Zco shares. The value of the Yco shares therefore tracks the value of the Zco shares. The taxpayer provides Callco, a Canadian corporation, with a call right that entitles it to purchase the taxpayer's Yco shares for a price determined by reference to the value of a corresponding number of Zco shares. In this situation, the taxpayer would retain a sufficient economic exposure to the Yco shares and the agreement to sell its Yco shares would therefore not be a derivative forward agreement.

Conversely, if the Yco shares do not have an embedded exchange right and instead, the taxpayer enters into an agreement to sell the Yco shares more than 180 days in the future for a price determined by reference to the value of the Zco shares, the agreement would be a derivative forward agreement.

The definition “derivative forward agreement” is used for a number of purposes. An income inclusion is provided in paragraph 12(1)(z.7) where a derivative forward agreement results in a profit. A deduction is provided in paragraph 20(1)(xx) where a derivative forward agreement results in a loss. An increase in the adjusted cost base of the capital property purchased or sold is provided by paragraphs 53(1)(s) and (t) where an amount is included in a taxpayer's income under paragraph 12(1)(z.7). Similarly, a decrease in the adjusted cost base of the capital property is provided in paragraphs 53(2)(w) and (x) where an amount is deductible under paragraph 20(1)(xx).

For further information, see the commentary on paragraphs 12(1)(z.7), 20(1)(xx), 53(1)(s) and (t) and 53(2)(w) and (x).

Example – Forward Sale

A mutual fund trust purchases a portfolio of non-dividend paying Canadian securities worth \$100 million. These are capital properties to the trust. The trust then enters into an agreement to sell the portfolio of Canadian securities to a counterparty in five years for a price determined by reference to the performance of a bond fund (i.e., the price is equivalent to what a \$100 million investment in the bond fund would be worth after five years).

At the end of the five-year term of the forward sale agreement, the portfolio of Canadian securities is worth \$110 million and the notional investment in the bond fund would be worth \$125 million. The portfolio of Canadian securities would therefore be sold for \$125 million (irrespective of the fair market value of the Canadian securities portfolio at the end of the five-year term).

The sale agreement would be a derivative forward agreement. It has a term in excess of 180 days. The difference between the fair market value of the property sold at the time of entering into the agreement (\$100 million) and the sale price (\$125 million) is determined by reference to an underlying interest (i.e., the notional investment in the bond fund) that is unrelated to the property sold. Lastly, the sale agreement has the effect of eliminating a majority of the trust's opportunity for gain or profit and risk of loss in respect of the Canadian securities portfolio.

The mutual fund trust would be required to include \$25 million in computing its income for the year of the sale under paragraph 12(1)(z.7), being the difference between the fair market value of the property at the time the agreement is entered into (\$100 million) and its sale price (\$125 million). The total adjusted cost base of the Canadian securities would be increased by \$25 million under paragraph 53(1)(t) so that there would be no capital gain or loss on the disposition of the Canadian securities for \$125 million.

Example – Forward Purchase

A mutual fund corporation enters into an agreement to purchase a portfolio of Canadian securities in five years. It prepays its obligation to purchase the portfolio upon entering into the agreement for \$100 million. The value of the Canadian securities to be delivered on settlement of the agreement is determined by reference to the performance of a fund that invests primarily in dividend-paying foreign equities (i.e., the value of Canadian securities to be delivered is equivalent to what a \$100 million investment in the equity fund would be worth after five years). The securities purchased are capital properties to the mutual fund corporation.

At the end of five years, the notional investment in the equity fund would be worth \$125 million. The counterparty to the purchase agreement therefore delivers a portfolio of Canadian securities to the mutual fund corporation with a value of \$125 million, which is immediately sold by the mutual fund corporation for cash proceeds of \$125 million. The composition of the Canadian securities portfolio is not particularly relevant, provided the purchaser is able to sell the purchased securities immediately for their fair market value (i.e., they are sufficiently liquid).

The purchase agreement would be a derivative forward agreement. It has a term in excess of 180 days. The difference between the value of the property delivered (i.e., the Canadian securities portfolio) and the price paid for the property is unrelated to the economic performance of the property. It is based on the performance of the equity fund (i.e., the underlying interest).

The mutual fund corporation would be required to include \$25 million in its income under paragraph 12(1)(z.7), being the difference between the fair market value of the Canadian securities portfolio when the agreement is settled (\$125 million) and the price paid for the Canadian securities (\$100 million). Its total adjusted cost base of the Canadian securities would be increased by \$25 million under paragraph 53(1)(s). It would therefore have no gain or loss on the disposition of the Canadian securities for \$125 million.

The definition “derivative forward agreement” comes into force on March 21, 2013.

“estate”

The definition “estate” assigns to that term for the purposes of the Act the meaning it has under subsection 104(1). Subsection 104(1) provides that a reference to an estate is to be read as including, among other things, the executor or liquidator of successions having ownership or control of the estate property. The English version of the definition is amended to clarify that a reference to estate includes, for civil law, a succession. The term “*succession*” used in French version of the Act describes both the common-law and civil law institutions without requirement for further amendment. This amendment comes into force on Royal Assent.

“LIA policy”

The new definition “LIA policy” describes a leveraged insured annuity arrangement entered into after March 20, 2013. In particular, an LIA policy is one in respect of which funds, borrowed after March 20, 2013, are used in connection with a lifetime annuity and a life insurance policy. The policy and the annuity are both issued on the life of an individual and the annuity provides that payments are to continue for a period that ends no earlier than the death of the individual. The lender is assigned an interest in the policy and in the annuity contract and the borrowed amount is repayable at a time that is determined based on the death of the individual.

A series of related amendments that apply to LIA policies are intended to eliminate a number of income tax benefits previously available in respect of leveraged insured annuities. For further information, see the commentary on paragraph 20(1)(e.2), subsection 70(5.31) and the definition “capital dividend account” in subsection 89(1) of the Act, and subsections 201(5.1) and 306(1) of the *Income Tax Regulations*.

This amendment applies to taxation years that end after March 20, 2013.

“majority-interest partner”

The term “majority interest partner” is amended to refer instead to a “majority-interest partner”. A number of related amendments are made to provisions in the Act that refer to the term and that do not currently use a hyphen in the reference. This amendment comes into force on Royal Assent.

“synthetic disposition arrangement”

A synthetic disposition arrangement in respect of a property owned by a taxpayer is generally any agreement, series of agreements or other arrangement that allows a taxpayer to eliminate all or substantially all of both the taxpayer’s risk of loss and opportunity for gain or profit in respect of the property for a definite or indefinite period of time. A synthetic disposition arrangement would not include an arrangement that eliminates only the taxpayer’s risk of loss or only the taxpayer’s opportunity for gain or profit.

A taxpayer’s opportunity for gain or profit in respect of a property would include the taxpayer’s rights (whether contingent or absolute) to earn income (e.g., dividends) or to obtain other benefits in respect of the property and the taxpayer’s right to economically participate in any increase in the value of the property. Likewise, a taxpayer’s risk of loss would include any liabilities (whether contingent or absolute) or obligations to provide benefits in respect of the property and the taxpayer’s economic exposure to any decreases in the value of the property.

A taxpayer will not be considered to retain opportunity for gain or profit in respect of a property if the arrangement provides for an offsetting liability (e.g., where a taxpayer has a right to receive dividends on shares it owns, but has a corresponding obligation to pay the amount of any dividends it receives to

a third party). Similarly, a taxpayer will not be considered to retain risk of loss where the arrangement provides for an offsetting benefit.

The determination of whether all or substantially all of a taxpayer's risk of loss and opportunity for gain or profit in respect of a property has been eliminated is highly factual. Depending on the circumstances, a taxpayer might be considered to have eliminated their risk of loss even if, for example, any or all of the following are retained:

- risk that a dividend or other return may not be paid or provided in relation to the property;
- risk as to a worsening of the creditworthiness of any party to the arrangement;
- risk as to changes in interest rates; or
- risk as to fluctuations in foreign currency exchange rates.

Similarly, depending on the circumstances, a taxpayer might be considered to have eliminated their opportunity for gain or profit even if, for example, any or all of the following are retained:

- opportunity to benefit from a dividend or other return being paid or provided in relation to the property;
- opportunity to benefit from an improvement in the creditworthiness of any party to the arrangement;
- opportunity to benefit from changes in interest rates; or
- opportunity to benefit from fluctuations in foreign currency exchange rates.

Although the definition “synthetic disposition arrangement” applies in respect of a property, there is no requirement that the agreement or arrangement or series of agreements be legally related to the property. For example, a synthetic disposition arrangement in respect of a property of a taxpayer could involve a cash settled derivative that offsets the taxpayer's economic interest in the property but that does not require that the taxpayer own the underlying property.

The synthetic disposition rules are based on the effects of an arrangement. Since different components of a synthetic disposition arrangement can be entered into by different parties, the definition contains a deeming rule that applies to arrangements that are entered into by non-arm's length persons or partnerships. For the purpose of determining whether an arrangement has the effect of eliminating a taxpayer's risk of loss and opportunity for gain or profit, arrangements entered into by non-arm's length persons and partnerships are deemed to have been entered into by the taxpayer. Where an arrangement is entered into by a person or partnership that does not deal at arm's length with the taxpayer, it must be reasonable to conclude that the arrangement was entered into, in whole or in part, with the purpose of achieving this effect. This ensures that the synthetic disposition rules will not apply to a taxpayer when a non-arm's length person inadvertently enters into a transaction that economically offsets a transaction entered into by the taxpayer.

Below are a number of simplified examples that illustrate the general types of considerations that are relevant in determining whether or not there is a synthetic disposition arrangement. Application of the synthetic disposition rules in a particular situation will depend largely on its facts.

Examples – Put-Call Arrangement

Example 1 (synthetic disposition arrangement) – A taxpayer owns a non-income producing property with a value of \$85. The taxpayer acquires a right to sell the property for \$100 in five years (a put) and grants a right to buy the property for \$100 in five years (a call). The taxpayer has eliminated all or substantially all of both the taxpayer's risk of loss and opportunity for gain or profit in respect of the property. At the end of five years, if the property is worth \$115, the call option holder will exercise the right and purchase the property for \$100. If, instead, the property is worth \$85 at the end of five years, the taxpayer would exercise the put right and sell the property for \$100.

Example 2 (synthetic disposition arrangement) – A taxpayer owns shares of a publicly traded company with a value of \$100 and the company is not expected to pay dividends in the foreseeable future. The taxpayer buys (for \$4) a right to sell the property for \$100 in two years and sells (for \$4) a right to buy the property for \$102 in two years. The taxpayer would have entered into a synthetic disposition arrangement because the taxpayer has eliminated substantially all their risk of loss and opportunity for gain or profit in respect of the property. The taxpayer would also be considered to have entered into a synthetic disposition arrangement if the taxpayer sold (for \$99) a right to buy the property for \$2 in two years, as it would be reasonable to expect the option holder to exercise the option.

Example 3 (not a synthetic disposition arrangement) – A taxpayer owns a property with a value of \$100. The taxpayer buys (for \$1) a right to sell the property for \$50 in five years and sells (for \$1) a right to buy the property for \$150 in five years. In this example, the taxpayer would retain a significant economic exposure to the property and would generally not be considered to have eliminated all or substantially all of either of the taxpayer's risk of loss or opportunity for gain or profit.

Examples – Secured Loan

Example 1 (synthetic disposition arrangement) – A taxpayer owns a property with a value of \$100. As part of an arrangement, the taxpayer receives a loan of \$100 and receives a right to settle the loan by transferring the property to the lender. Also as part of the arrangement, the lender obtains the right to acquire the property for \$100. The taxpayer has eliminated substantially all of both the taxpayer's risk of loss and opportunity for gain or profit in respect of the property. If the property's value exceeds \$100 at the end of the term of the loan, the lender would exercise its right to acquire the property for \$100. If the property's value is less than \$100 at the end of the term of the loan, the taxpayer would use the property to settle the loan.

Example 2 (not a synthetic disposition arrangement) – A taxpayer owns a property with a value of \$100. A taxpayer receives a loan of \$100 that is secured by the property. The taxpayer would generally not be considered to have eliminated substantially all of either of the taxpayer's risk of loss or opportunity for gain or profit. Even if the taxpayer received a right to settle the debt with the property, the taxpayer would not generally be considered to have entered into a synthetic disposition arrangement since the taxpayer would not have eliminated all or substantially all of the taxpayer's opportunity for gain or profit in respect of the property.

Examples – Future Sale

Example 1 (synthetic disposition arrangement) – A taxpayer enters into an agreement to sell a non-income producing property with a current fair market value of \$100 in five years for \$120. Upon entering into the agreement, the taxpayer is obligated to sell the property at the future date for the specified price. The taxpayer has eliminated all or substantially all of both the taxpayer's risk of loss and opportunity for gain or profit in respect of the property because the taxpayer's return is determined without regard to the economic performance of the property.

Example 2 (synthetic disposition arrangement) – A taxpayer enters into an agreement to sell 100 shares of ABC Co. with a current fair market value of \$100 in five years for \$120. The \$120 sale price will be decreased based upon dividends paid on the ABC Co. shares. Alternatively, the taxpayer is required to pass on the dividends it receives to the purchaser. As with Example 1, the taxpayer has eliminated all or substantially all of both the taxpayer's risk of loss and opportunity for gain or profit in respect of the property because the taxpayer's return is determined without regard to the economic performance of the property.

Example 3 (not a synthetic disposition arrangement) – A taxpayer enters into an agreement to sell a property at a future date at a price determined by the value of the property at that future date. The taxpayer would not be considered to have eliminated substantially all of either their risk of loss or opportunity for gain or profit.

Example 4 (not a synthetic disposition arrangement) – A taxpayer enters into an agreement to sell 100 shares of ABC Co. to a purchaser for \$100, but only if the purchaser obtains regulatory approval for the sale. When the agreement was entered into, there was a real risk that regulatory approval would not be obtained. The taxpayer has not eliminated all or substantially all of the taxpayer's risk of loss and opportunity for gain or profit in respect of the shares while this bona fide condition precedent remains outstanding.

Examples – Short Sale

Example 1 (synthetic disposition arrangement) – A taxpayer borrows 100 ABC Co. shares and immediately sells the shares for their fair market value. The taxpayer then buys 100 ABC Co. shares. The taxpayer would have entered into a synthetic disposition arrangement in respect of the 100 ABC Co. shares that were purchased because the arrangement has eliminated substantially all of both the taxpayer's risk of loss and opportunity for gain or profit in respect of the property.

Example 2 (not a synthetic disposition arrangement) – A subsidiary of a large corporation makes a portfolio investment in 100 ABC Co. shares because its investment manager has a bullish outlook on ABC Co. Another subsidiary sells 100 ABC Co. shares short because its investment manager has a bearish outlook on ABC Co. The short investment position is taken without knowledge of the long investment. While, taken together, the long and short positions economically offset each other, it cannot be said that the short position was entered into for the purpose of eliminating all or substantially all of the risk of loss and opportunity for gain or profit of the long position.

Examples – Swap

Example 1 (synthetic disposition arrangement) – A taxpayer owns ABC Co. shares with a cost of \$10 and a fair market value of \$100. The taxpayer enters into a five-year total return swap with a counterparty under which the taxpayer will pay the counterparty the amount of any dividends plus any increases in value in the ABC Co. shares at the end of five years. In return, the taxpayer receives swap payments based on LIBOR as well as an amount equal to any decrease in the value of the ABC Co. shares at the end of five years. This is a synthetic disposition arrangement because the taxpayer has eliminated substantially all of both the taxpayer’s risk of loss and opportunity for gain or profit in respect of the property over the five-year term of the total return swap even if the taxpayer retains ownership of the property at the end of the term of the agreement.

Example 2 (not a synthetic disposition arrangement) – A taxpayer owns ABC Co. shares with a cost of \$10 and a fair market value of \$100. The taxpayer enters into a five-year swap with a counterparty under which the taxpayer will pay the counterparty the amount of any dividends received on the ABC Co. shares (but no amount based on any increase in the value of the ABC Co. shares). In return, the taxpayer receives swap payments based on the dividends received on XYZ Co. shares (but no amount based on any decrease in the value of the ABC Co. shares). The price of the ABC Co. shares is volatile and most of the taxpayer’s opportunity for gain or profit (and risk of loss) in respect of the shares is based on the potential appreciation (or depreciation) in the value of the ABC Co. shares. Since the taxpayer retains a significant economic exposure to the ABC Co. shares, the arrangement would not be a synthetic disposition arrangement.

The definition “synthetic disposition arrangement” comes into force on March 21, 2013.

“synthetic disposition period”

The “synthetic disposition period” of a synthetic disposition arrangement is the definite or indefinite period of time during which the one or more agreements or other arrangements have the effect, or would have the effect if entered into by the taxpayer, of eliminating all or substantially all the taxpayer’s risk of loss and opportunity for gain or profit in respect of a property. The term “synthetic disposition arrangement” is also defined in subsection 248(1).

The definition “synthetic disposition period” comes into force on March 21, 2013.

“trust”

The definition “trust” assigns to that term for the purposes of the Act the meaning it has under subsection 104(1). The definition is amended to clarify that a reference to a trust in the Act includes, unless the context otherwise requires, an estate. This is intended to ensure that the provisions of the Act as a whole apply, unless otherwise required, in a manner that is consistent with the treatment of an estate as a trust for purposes of subdivision k of Division B of Part I of the Act. This amendment comes into force on Royal Assent.

“10/8 policy”

The new definition “10/8 policy” generally describes a life insurance policy in respect of certain arrangements under which a taxpayer invests amounts in the policy that are then, in effect, returned to the taxpayer under a collateral loan arrangement (i.e., where the lender has been assigned an interest in the policy or in an investment account in respect of the policy that becomes available in connection with the borrowing) or a policy loan arrangement (i.e., under which amounts are advanced to the

policyholder under the terms of the insurance contract, as described in the definition “policy loan” in subsection 148(9), and in connection with which an investment account in respect of the policy becomes available). For the policy to be a 10/8 policy, an additional condition must be met; either:

- The rate of interest on an obligation held in an investment account in respect of the policy is determined by reference to the rate of interest on the borrowing or the policy loan; or
- The maximum amount of an investment account in respect of the policy is determined by reference to the amount of the borrowing or the policy loan.

A series of related amendments apply to 10/8 policies and are intended to eliminate the income tax benefits previously available in respect of these arrangements. In addition, a transitional rule is provided to facilitate the termination of existing arrangements. For more information, see the commentary on paragraph 20(1)(e.2), subsection 20(2.01), the definition “capital dividend account” in subsection 89(1), and subsection 148(5).

This amendment applies to taxation years that end after March 20, 2013.

Clause 51

Year-end on certain events

ITA

249(4)

Subsection 249(4) of the Act provides that if a control of a corporation is acquired at any time, the corporation is deemed to have a year-end immediately before that time, and to start a new taxation year at that time. However, if control of the corporation is acquired within seven days of the corporation’s preceding taxation year having ended, the corporation can (unless there is an intervening acquisition of control of the corporation during those seven days) elect to extend that preceding taxation year to include those additional days.

Subsection 249(4) is amended to extend its application to trusts. Specifically, the subsection applies to a taxpayer that is a corporation or trust and that is subject to a loss restriction event. The rules in existing paragraphs 249(4)(a), (b) and (d) are included in new paragraph 249(4)(a), providing a structure consistent with that found in paragraph 149(10)(a). Consequential on this change, existing paragraph 249(4)(c) is renumbered as paragraph 249(4)(b).

For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

Clause 52

Affiliated persons

ITA

251.1

Section 251.1 of the Act sets out rules for determining when persons (including partnerships) are affiliated with one another, which is relevant to a number of provisions of the Act, most notably those restricting the realization of losses on certain transfers.

ITA

251.1(1), (3) and (4)

Paragraph 251.1(1)(e) of the Act provides that a partnership and a majority interest partner of the partnership are affiliated with each other. The reference in the English version of the paragraph to “majority interest partner” is changed to “majority-interest partner” consequential on a similar change to the definition “majority-interest partner” in subsection 248(1).

Paragraph (a) of the definition “majority-interest group of partners” in subsection 251.1(3) defines a majority-interest group of partners of a partnership to mean a group of persons each of whom has an interest in the partnership such that if one person held all of those interests that person would be a majority interest partner of the partnership. The reference in the English version of the paragraph to “majority interest partner” is changed to “majority-interest partner” consequential on a similar change to the definition “majority-interest partner” in subsection 248(1).

Subparagraph 251.1(4)(d)(iv) provides that for purposes of section 251.1 in determining whether a person is affiliated with a trust, in determining whether a contributor to one trust is affiliated with a contributor to another trust, individuals connected by blood, marriage common-law partnership or adoption are deemed to be affiliated with one another. The English version of the subparagraph is amended to replace the reference to connection by blood with a reference to connection by blood relationship. This clarifies that the relationships described in the subparagraph are intended to be connected as described in subsection 251(6), which refers to blood relationship.

These amendments come into force on Royal Assent.

Clause 53

Loss restriction event

ITA

251.2

New section 251.2 of the Act contains rules for determining when a taxpayer is subject to a loss restriction event. A taxpayer’s ability to carry over for income tax purposes certain undeducted amounts is constrained if the taxpayer is subject to a loss restriction event.

New section 251.2 comes into force on March 21, 2013.

Definitions

ITA

251.2(1)

Subsection 251.2(1) of the Act contains definitions that apply for purposes of section 251.2.

“beneficiary”

Beneficiary under a trust has the same meaning as in subsection 251.1(3), which extends its ordinary meaning to include a person beneficially interested in the trust.

“equity”

Equity of a corporation, trust or partnership has the same meaning as in subsection 122.1(1) determined without reference to paragraph (e) of the definition in that subsection. Equity means shares of the capital stock of a corporation, a capital interest or income interest in a trust, an interest as a member of a partnership and certain participating debt issued by the relevant entity.

“equity value”

Equity value of a corporation, trust or partnership has the same meaning as in subsection 122.1(1). Equity value is, in effect, the fair market value of all of the relevant entity’s equity (ignoring participating debt).

“majority-interest beneficiary”

Majority-interest beneficiary has the same meaning as in subsection 251.1(3).

“majority-interest group of beneficiaries”

Majority-interest group of beneficiaries has the same meaning as in subsection 251.1(3).

“majority-interest group of partners”

Majority-interest group of partners has the same meaning as in subsection 251.1(3).

“person”

A person includes a partnership.

“specified right”

A person’s specified right in respect of a trust is similar to the rights in respect of a corporation described in subparagraphs 251(5)(b)(i) and (ii) of the Act. A specified right in respect of a trust is a right to acquire, or to cause a trust to redeem or cancel, equity of the trust. Specified rights may be held under a contract, in equity or otherwise and may be immediate or future, absolute or contingent. Specified rights are subject to an anti-avoidance rule in subparagraph 251.2(5)(b)(iii). For more information, see the commentary on that subparagraph.

“subsidiary”

A subsidiary of a particular person (including a partnership) means a corporation, partnership or trust (the subject entity) in which the particular person holds directly or indirectly a majority interest (i.e., property representing more than 50% of the fair market value of the subject entity’s equity value). Under paragraph (a) of the definition, the determination of whether a subject entity is the subsidiary of a particular person is made having regard to both property held by the particular person that is equity (including participating debt) of the subject entity and property held by the particular person that derives its value from equity of the subject entity. For example, in making the determination of whether a subject entity corporation is a subsidiary of a particular person, regard would be had to shares of the capital stock of the subject entity held by the particular person, as well as a capital interest in a trust that is held by the particular person if the trust in turn holds, directly or indirectly, equity of the subject entity.

Paragraph (b) of the definition applies to determine whether the property held by a particular person and described in paragraph (a) of the definition constitutes, in effect, a majority interest in the subject entity. The equity value of the subject entity is used for this purpose. Equity value is the fair market value of all of the subject entity’s equity (ignoring participating debt) at the relevant time. If the total fair market value of a particular person’s property described in paragraph (a) in respect of a subject entity (but in the case of property described in subparagraph (a)(ii), only the applicable portion of that fair market value) is more than 50% of the subject entity’s equity value, the subject entity is treated as that person’s subsidiary.

The subsidiary concept is used in paragraphs 251.2(3)(c) and (4)(a) in determining whether a trust is subject to a loss restriction event at any time. For more information, see the commentary on those paragraphs.

Loss restriction event

ITA

251.2(2)

Subsection 251.2(2) of the Act describes the circumstances in which a corporation or trust is subject to a loss restriction event. A corporation is subject to a loss restriction event when control of the corporation is acquired by a person or group of persons. For this purpose, subsection 256(7) applies. For further information, see the commentary on that subsection.

A trust is subject to a loss restriction event at any time after creation of the trust and March 20, 2013 if at that time a person becomes majority-interest beneficiary, or a group of persons becomes a majority-interest group of beneficiaries, of the trust. For this purpose, subsection 251.2(4) deems certain transactions and events to cause a person to become a majority-interest beneficiary of a trust. Subsection 251.2(4) is, however, subject to subsection 251.2(3), which describes certain transactions and events that on their own are deemed not to cause a person to become a majority-interest beneficiary, or a group of persons to become a majority-interest group of beneficiaries, under a trust. A number of anti-avoidance rules in subsection 251.2(5) also apply in determining whether at any time a person becomes a majority-interest beneficiary, or a group of persons becomes a majority-interest group of beneficiaries, of a trust. For further information, see the commentary on subsections 251.2(3), (4) and (5).

Trust – exceptions

ITA

251.2(3)

Subsection 251.2(3) of Act describes certain transactions and events in respect of which, for the purpose of determining whether a particular trust is subject to a loss restriction event, a person or group of persons is deemed not to become a majority-interest beneficiary or majority-interest group of beneficiaries, respectively, of the particular trust. In general terms, subsection 251.2(3) describes transfers or acquisitions of trust equity within affiliated groups of persons.

Paragraph 251.2(3)(a) deems a person not to become a majority-interest beneficiary, and a group of persons not to become a majority-interest group of beneficiaries, as the case may be, of a particular trust solely because of the acquisition of equity (generally, a capital interest or income interest) of the particular trust by

- a particular person from a person with whom they are affiliated
- a particular person who is affiliated with the trust;
- the estate of a deceased individual from the individual as a matter of the individual's succession; and
- a particular person from an estate if the estate acquired the property from an individual as described in the immediately preceding bullet, and the particular person was affiliated with the individual immediately before the individual's death.

Paragraph 251.2(3)(b) deems a person not to become a majority-interest beneficiary, and a group of persons not to become a majority-interest group of beneficiaries, as the case may be, of a trust solely because of certain transactions or events. These include a variation of the terms of the trust, as well as certain transactions effected under the terms of the trust or by decision of the trustees. The paragraph applies provided that immediately after the relevant transaction or event the only persons that are majority-interest beneficiaries, or members of a group of majority-interest beneficiaries, in the trust are persons that were affiliated with the trust immediately before that time (or, where the transaction involves the extinguishment of a beneficial interest in the trust held by a deceased individual's estate and acquired by the estate from the individual as a matter of the individual's succession, those persons are affiliated with the trust immediately before the individual's death).

Paragraph 251.2(3)(c) provides that a person is deemed not to become a majority-interest beneficiary, and a group of persons is deemed not to become a majority-interest group of beneficiaries, as the case may be, of a particular trust solely because the equity holders (i.e., beneficiaries, and holders of participating debt, of the particular trust) transfer all of that equity to a corporation, partnership or another trust (the acquirer). The paragraph applies only if a number of other conditions are met. Firstly, the only consideration for the transfer can be shares, partnership memberships or trust beneficial interests, as the case may be, of the acquirer. Second, the acquirer must be, in effect, a new entity, not having held property before the transfer, or having held before the transfer only property of nominal value. Third, immediately after the transfer the acquirer cannot be a subsidiary (as defined in subsection 251.2(1)) of another person and, if the acquirer is a corporation, cannot be under the legal or factual control of another person. (Note that even if this third additional condition is met, the trust may be subject to a loss restriction event by operation of paragraph 251.2(4)(a) if the acquirer subsequently becomes the subsidiary of another person).

Paragraph 251.2(3)(c), in effect, applies in respect of certain internal reorganizations involving the interests of all the beneficiaries under a trust.

Paragraph 251.2(3)(d) provides that a person is deemed not to become a majority-interest beneficiary, and a group of persons is deemed not to become a majority-interest group of beneficiaries, as the case may be, of a particular trust solely because a transfer of equity of the particular trust to a corporation, partnership or another trust (the acquirer). The paragraph applies provided that a number of additional conditions are met. The particular trust must have had a majority-interest beneficiary, or a group of persons as a majority-interest group of beneficiaries, immediately before the transfer. In addition, that beneficiary or group of beneficiaries must be immediately after the transfer affiliated with the acquirer as a result of being a beneficiary or member of the acquirer or, in the case of a corporate acquirer, having legal or factual control of the acquirer, and not cease to be so affiliated with the acquirer as part of a series of transactions or events that includes the transfer.

Paragraph 251.2(3)(d), in effect, applies in respect of certain reorganizations involving the interests of beneficiaries under a trust provided that the affected interests remain within, and there is no change in, the beneficiary or group of beneficiaries affiliated with the trust.

Paragraph 251.2(3)(e) provides relief in respect of certain transactions the parties to which were obligated to complete under a written agreement entered into by the parties before March 21, 2013. These transactions are ignored in determining whether a person or partnership becomes after March 20, 2013 a majority-interest beneficiary, or a group of persons becomes a majority-interest group of beneficiaries, of a trust. The paragraph does not prevent a trust from being subject to a loss restriction

event as a result of other transactions (including those involving the same parties), but that are not completed pursuant to the agreement.

Trusts – additional cases

ITA

251.2(4)

Subsection 251.2(4) of the Act describes certain transactions and events in respect of which, subject to the unusual circumstance in which subsection 251.2(3) would also apply to the same transaction or event, a trust is deemed to be subject to a loss restriction event (i.e., by deeming a notional person to have become at the relevant time a majority-interest beneficiary of the trust).

Paragraph 251.2(4)(a) applies where a corporation, partnership or trust (the subject entity) is a majority-interest beneficiary, or a member of a group of majority-interest beneficiaries, of a trust. If the subject entity becomes at any time a subsidiary of another person (the acquirer), the paragraph deems, subject to the exceptions in subparagraphs 251.2(4)(a)(i) and (ii), a notional person to become a majority-interest beneficiary of the particular trust, resulting in the trust being subject to a loss restriction event. The exception in subparagraph 251.2(4)(a)(i) applies to the trust if the acquirer and the trust are affiliated immediately before that time. The exception in subparagraph 251.2(4)(a)(ii) applies if, as part of a series of transactions that includes the subject entity becoming the acquirer's subsidiary at that time, paragraph 251.2(4)(a) has already applied to deem a person to become a majority-interest beneficiary of the trust. Paragraph 251.2(4)(a) ensures that a majority-interest beneficiary, or majority-interest group of beneficiaries, of a trust cannot be used as a “blocker” between the trust and its owners (determined without reference to the beneficiary or group) to avoid the trust being subject to a loss restriction event where those owners change.

Paragraph 251.2(4)(b) provides a “reverse takeover” rule, similar to those found in paragraphs 256(7)(c) and (c.1) in respect of the acquisition of control of a corporation, that applies if as part of a series of transactions or events two or more persons acquire at a particular time equity of a particular trust (for example, a trust with unused tax attributes available for carry over) in exchange for or upon a redemption or surrender of equity of, or as a consequence of a distribution from, a corporation, partnership or another trust (the target). In these circumstances the paragraph deems, subject to the exceptions in subparagraphs 251.2(4)(b)(i) to (iii), a notional person to become a majority-interest beneficiary of the particular trust, resulting in the trust being subject to a loss restriction event.

The exception in subparagraph 251.2(4)(b)(i) applies to the particular trust if the target, or a person affiliated with the target, was immediately before the particular time affiliated with the particular trust. Subparagraph 251.2(4)(b)(ii) applies to the particular trust if, were a hypothetical person to have acquired all the equity of the particular trust that was actually acquired at or before the particular time and as part of the series, that hypothetical person would not be a majority-interest beneficiary of the trust. Subparagraph 251.2(4)(b)(iii) applies to the particular trust if as part of the series paragraph 251.2(4)(b) has already applied to deem a person to become a majority-interest beneficiary of the trust.

Trusts – special rules of application

ITA

251.2(5)

Subsection 251.2(5) of the Act contains rules of application for the purpose of determining whether a trust is subject to a loss restriction event at any time. Paragraph 251.2(5)(a) contains rules that apply in determining whether persons are affiliated with each other:

- except for the purposes of the definition “subsidiary” in subsection 251.2(1), legal, and not factual, control of a corporation is to be used;
- natural persons are affiliated with each other if they are connected (including within the meaning of subsection 251(6)) by blood relationship, adoption, marriage or common-law partnership; and
- certain conditions in subsections 251.2(3) and (4) requiring that persons be affiliated are deemed not be met if a person acquires equity and it can reasonably be concluded that one of the reasons for the acquisition or any agreement in respect of the acquisition was to cause the relevant condition to be met.

Paragraph 251.2(5)(b) contains a series of anti-avoidance rules that apply in respect of certain transactions or events undertaken for reasons that include avoiding a trust being subject to a loss restriction event or the consequences under the Act of a trust being subject to a loss restriction event. Specifically, the paragraph applies in determining whether a particular person becomes at any time a majority-interest beneficiary, or a particular group of persons becomes a majority-interest group of beneficiaries, of a trust. For this purpose, the fair market value of each person’s capital interest and income interest in the trust is to be determined at and immediately before that time:

- without reference to the portion of that fair market value that is attributable to property acquired, or to a change in the fair market value of all or part of any capital interest or income interest in the trust, if it can reasonably be concluded that one of the reasons for the acquisition or change is to cause paragraph 251.2(2)(b), or any provision that applies by reference to a trust being subject to a loss restriction event at any time, not to apply; and
- as if each specified right held immediately before that time by the particular person, or by a member of the particular group, in respect of the trust is at that time exercised, if it can reasonably be concluded that one of the reasons for the acquisition of the right is to cause paragraph 251.2(2)(b), or any provision that applies by reference to a trust being subject to a loss restriction event at any time, not to apply.

Trusts – time of day

ITA

251.2(6)

Subsection 251.2(6) of the Act deems the time at which a trust is subject to a loss restriction event on a given day to be the beginning of that day (and not any other time on that day at which the event actually occurred). A trust can elect that the deeming rule not apply to it by filing an election with its return of income for its taxation year that ends immediately before the trust is subject to the loss restriction event. A related amendment to section 600 of the *Income Tax Regulations* adds this election to the list of elections for which permission may be sought from the Minister of National Revenue to

amend, revoke or extend the time to file an election. For further information, see the commentary on section 600 of the *Income Tax Regulations*.

Clause 54

Acquiring control

ITA

256

Section 256 of the Act provides rules for determining whether corporations are to be considered to be associated and whether control of a corporation has been acquired for the purposes of the Act.

ITA

256(7)

Subsection 256(7) of the Act provides rules for determining whether control of a corporation is deemed to be, or not to be, acquired for the purposes of the Act.

The subsection's preamble, which lists the provisions to which the rules in the subsection apply, is amended to replace the references to certain provisions with a reference to paragraph 251.2(2)(a). The replaced references are to: paragraph 80.04(h), subsections 10(10), 13(21.2) and (24), 14(12), 18(15), 40(3.4), 66(11.4) and (11.5) and 249(4), sections 18.1, 37, 80, 111 (except subsection 111(11.4)) and 127 and the definition "superficial loss" in section 54. This change is consequential on amendments to the affected provisions to replace references in those provisions to the acquisition of control of a corporation with references to a taxpayer being subject to a loss restriction event. Paragraph 251.2(2)(a) sets out the circumstances in which a corporation is subject to a loss restriction event at any time – namely, if at that time control of the corporation is acquired by a person or group of persons. This amendment to the preamble to subsection 256(7) ensures that the affected provisions continue to apply as before, with the determination of whether control of a corporation is acquired at any time for purposes of the affected provisions made by reference to subsection 256(7) *via* paragraph 251.2(2)(a) (i.e., because of the reference to that paragraph in the preamble to subsection 256(7)). For further information, see the commentary on the affected provisions and on section 251.2.

This amendment comes into force on March 21, 2013.

ITA

256(7)(a)

Paragraph 256(7)(a) of the Act describes circumstances in which control of a corporation (or a corporation controlled by the corporation) is considered not to have been acquired for the purposes of certain provisions of the Act. Clause 256(7)(a)(i)(D) provides that control of a corporation is deemed not to be acquired solely because of the acquisition at any time of shares of any corporation by a particular person from an estate that arose on the death of another person to whom the particular person was related. This clause is amended to ensure that relief under the clause is available only in respect of shares acquired by a particular person from an estate of a deceased individual if the shares were acquired by the estate as a consequence of the death of that individual and the individual and the particular person were related immediately before the individual's death. The amendment is consistent with new subparagraph 251.2(3)(a)(iv), which applies in determining whether a trust is subject to a loss restriction event. For further information, see the commentary on section 251.2.

This amendment comes into force on Announcement Date.

ITA

256(7)(h) and (i)

New paragraph 256(7)(h) of the Act applies in circumstances in which a trust is subject to a loss restriction event at a particular time on or after Announcement Date and immediately before the particular time the trust, or a group of persons of which the trust is a member, controls a particular corporation. In this case, control of the particular corporation and of each corporation controlled by it is deemed to have been acquired at that time by a person or group of persons. This rule ensures that a trust not be used as a “blocker” between a corporation and its owners (determined without reference to the trust) to avoid an acquisition of control of the corporation when those owners change.

New paragraph 256(7)(i) applies in circumstances in which a trust, at a particular time on or after Announcement Date, controls a particular corporation and the trustee or other legal representative (the trustee) having ownership or control of the trust property (i.e., including shares of the capital stock of the particular corporation held by the trust) changes. Such a change may arise, for example, because of the death, resignation or substitution of a person acting as trustee.

Paragraph 256(7)(i) deems control of the particular corporation not to be acquired solely because of the change, provided that two additional conditions are met. The first additional condition requires that the change in trustees not be part of a series of transactions or events under which beneficial ownership of the trust property changes. The second additional condition requires that no amount of the income or capital of the trust to be distributed at or after the change in trustees be subject to a discretionary power.

These amendments come into force on March 21, 2013.

Deemed exercise of right

ITA

256(8)

Subsection 256(8) of the Act extends the circumstances in which an acquisition of control is considered to have occurred for the purposes of a number of provisions of the Act. If a taxpayer acquires a right referred to in paragraph 251(5)(b) with respect to shares, and it can reasonably be concluded that one of the main purposes of the acquisition of the right is to avoid the application of certain income tax provisions that are triggered on an acquisition of control, subsection 256(8) applies to treat the right as having been exercised.

Consequential on the introduction of the new corporate loss trading rules in section 256.1, subsection 256(8) is amended to add a reference to subsections 88(1.1) and (1.2). Subsection 88(1.1) allows a parent corporation under certain circumstances to use non-capital losses of a subsidiary corporation that has been wound up. Subsection 88(1.2) provides a similar rule with respect to net capital losses. Under both subsections, however, limits may apply where there is an acquisition of control of the parent or subsidiary, including where section 256.1 deems there to have been an acquisition of control of the parent or subsidiary.

This amendment comes into force on March 21, 2013.

Paragraph 256(8)(b) is amended to add subsection 251.2(2) to the list of provisions that are triggered by an acquisition of control and the intended avoidance of which can trigger the application of subsection 256(8). Subsection 251.2(2) provides that a corporation is subject to a loss restriction event

when control of it is acquired by a person or group of persons. For further information, see the commentary on section 251.2.

If subsection 256(8) applies, it treats the taxpayer as having exercised the right in question for a number of provisions for the purpose of determining whether control of the relevant corporation is acquired or whether the corporation is controlled by any person or group of persons. The list of provisions is amended by adding a reference to paragraph 251.2(2)(a), which provides that a corporation is subject to a loss restriction event when control of it is acquired by a person or group of persons. The list of provisions is also amended to add references to paragraphs 251.2(3)(c) and (d), which apply, in part, by reference to whether a corporation is controlled by a person or group of persons.

These amendments come into force on March 21, 2013.

Clause 55

Corporate tax-attribute trading

ITA

256.1

The Act contains a number of provisions meant to constrain the trading of corporate tax attributes among arm's length persons. Nevertheless, transactions intended to circumvent these provisions continue to be undertaken. Depending on the particular facts, these transactions are challenged by the Canada Revenue Agency based on existing rules in the Act. However, as any such challenge could be time-consuming and costly, the Government announced in Economic Action Plan 2013 that it is introducing new section 256.1 to ensure that the appropriate tax consequences apply to these transactions.

Definitions

ITA

256.1(1)

New subsection 256.1(1) of the Act provides definitions that apply for the purposes of section 256.1.

“attribute trading restriction”

An “attribute trading restriction” is defined to be a restriction on the use of a tax attribute arising on the application, either alone or in combination with other provisions, of various sections and subsections of the Act. Depending on the type of tax attribute, the restrictions deny or limit the deduction of, among other tax attributes, a corporation's loss carryover pools, investment tax credit carryover pools, resource expense pools and scientific research and experimental development expenditure pools. The definition “attribute trading restriction” is relevant for the purpose of applying the anti-avoidance rules in subsections 256.1(3) and (6), which deem an acquisition of control of a corporation to have occurred in certain circumstances. For further information, see the commentary on subsections 256.1(3) and (6).

“person”

The definition “person” includes a partnership.

“specified provision”

A “specified provision” is defined to be any of various provisions in the Act that generally restrict the deductible amount of a corporate tax attribute on an acquisition of control of the corporation. These restrictions apply, among other tax attributes, to limit the deductibility of a corporation’s loss carryover pools, investment tax credit carryover pools, resource expense pools and scientific research and experimental development expenditure pools. The definition “specified provision” is relevant for the purpose of applying the anti-avoidance rules in subsections 256.1(3) and (6), which deem an acquisition of control of a corporation to have occurred in certain circumstances. For further information, see the commentary on subsections 256.1(3) and (6).

These definitions come into force on March 21, 2013.

Application of subsection (3)

ITA

256.1(2)

New subsection 256.1(2) of the Act provides that subsection 256.1(3), which deems there to have been an acquisition of control of a corporation, applies at a particular time if

- shares of the capital stock of the corporation held by a person, or the total of all shares of the capital stock of the corporation held by members of a group of persons, have at the particular time a fair market value that exceeds 75% of the fair market value of all the shares of the capital stock of the corporation;
- shares of the capital stock of the corporation held by the person, or the total of all shares of the capital stock of the corporation held by members of the group, have immediately before the particular time a fair market value that does not exceed 75% of the fair market value of all the shares of the capital stock of the corporation (this condition ensures that subsection 256.1(3) does not apply more than once solely because the fair market value of the shares owned by the person or group, which is already above 75%, increases in value);
- the person or group does not control the corporation at the particular time; and
- it is reasonable to conclude that one of the main reasons that the person or group does not control the corporation is to avoid the application of one or more specified provisions.

Deemed acquisition of control

ITA

256.1(3)

New subsection 256.1(3) of the Act provides two rules that apply in respect of a corporation for the purpose of applying the attribute trading restrictions. First, paragraph 256.1(3)(a) provides that, for the purpose of applying the attribute trading restrictions, the person or group of persons referred to in subsection 256.1(2)

- is deemed to acquire control of the corporation, and each corporation controlled by the corporation, at the particular time. By deeming an acquisition of control of the corporation, and each corporation controlled by it, subsection 256.1(3) causes the attribution trading restrictions to apply to all those corporations; and

- is not deemed to have control of the corporation, and each corporation controlled by the corporation, at any time after the particular time solely because of the application of this provision. As a consequence, the person, or group of persons, referred to in subsection 256.1(2) will not have control of the affected corporations for the purposes of the Act solely because the attribute trading restrictions apply to the affected corporations. *De jure* control would continue to rest with the person, or group of persons, that has such control despite the application of the attribute trading restrictions to the affected corporations. As well, the affected corporations would, in general, continue to be associated with the corporations they were associated with before the application of subsection 256.1(3). For example, the affected corporations would remain part of the *de jure* controller's group for the purpose of deducting the small business deduction and investments tax credits, including refundable scientific research and experimental development tax credits.

Second, paragraph 256.1(3)(b) provides that, during the period that the 75% fair market value threshold is satisfied (i.e., the condition in paragraph 256.1(2)(a)), each corporation referred to in paragraph 256.1(3)(a) – and any corporation incorporated or otherwise formed subsequent to that time and controlled by that corporation – is deemed not to be related to, or affiliated with, any person to which it was related to, or affiliated with immediately before paragraph 256.1(3)(a) applies. Accordingly, these corporations cannot undertake loss consolidations within an affiliated, or related, group.

Special rules

ITA

256.1(4)

New subsection 256.1(4) of the Act provides two rules that apply for the purpose of applying the 75% fair market value threshold in respect of a person or group of persons under paragraph 256.1(2)(a). First, paragraph 256.1(4)(a) provides that, if it is reasonable to conclude that one of the reasons that one or more transactions or events occur is to cause a person, or a group of persons, not to hold shares having a fair market value that exceeds 75% of the fair market value of all the shares of the capital stock of a corporation, paragraph 256.1(2)(a) is to be applied without reference to those transactions or events. This rule provides that such transactions or events are to be ignored in determining whether the share holdings of the person or group of persons exceeds 75% of the fair market value of all the shares of the corporation.

Second, paragraph 256.1(4)(b) provides that the person, or each member of the group, is deemed to have exercised each right that is held by the person or a member of the group and that is referred to in paragraph 251(5)(b) in respect of a share of the corporation referred to in paragraph 256.1(2)(a). Accordingly, whether the 75% fair market value threshold in paragraph 256.1(2)(a) has been exceeded by a person, or a group, is to be determined on the basis that the person, and each member of a group, has exercised those rights.

If share value nil

ITA

256.1(5)

New subsection 256.1(5) of the Act provides deeming rules that apply in certain circumstances for the purposes of subsections 256.1(2) and (4). The rules provide that, if the fair market value of the shares of the capital stock of a corporation is nil at any time, then for the purpose of determining the fair

market value of those shares, the corporation is deemed, at that time, to have assets net of liabilities equal to \$100,000 and to have \$100,000 of income for the taxation year that includes that time.

Deemed acquisition of control

ITA

256.1(6)

New subsection 256.1(6) of the Act provides an anti-avoidance rule that deems the attribute trading restrictions to apply in certain circumstances. If, at any time as part of a transaction or event or series of transactions or events, control of a particular corporation is acquired by a person, or a group of persons, and it can reasonably be concluded that one of the main reasons for the acquisition of control is so that a specified provision does not apply to one or more corporations, the attribute trading restrictions are deemed to apply to each of those corporations as if control of each of those corporations is acquired at that time.

In general terms, subsection 256.1(6) counters tax avoidance structures under which corporate tax attributes were traded by arm's length persons in circumstances where a corporation (the loss corporation) that has undeducted tax attributes acquires control of a corporation (the profitable corporation) that is profitable. Because the loss corporation (or a person related to or affiliated with it) acquires control of the profitable corporation (or a corporation related to or affiliated with it), the owners of the corporations avoid, subject to the general anti-avoidance rule, an acquisition of control of the loss corporation and the application of the tax attribute trading rules. These structures have generally relied on the Supreme Court of Canada's decision in *Duha Printers (Western) Ltd. v. The Queen*, [1998] 1 SCR 795.

Section 256.1 comes into force on March 21, 2013, except that it does not apply to an event or transaction that occurs

- before March 21, 2013, or
- after March 20, 2013 pursuant to an obligation created by the terms of an agreement in writing entered into between parties before March 21, 2013. For this purpose, parties will be considered not to be obligated if one or more of those parties may be excused from fulfilling the obligation as a result of changes to the Act.

Income Tax Regulations

Clause 56

Investment income

ITR

201

Section 201 of the *Income Tax Regulations* (the “Regulations”) imposes a requirement on certain persons to provide annual information returns in respect of investment income, including interest and dividends.

ITR

201(5.1)

Subsection 201(5) of the Regulations requires an insurer to make an information return in prescribed form if the insurer is a party to a life insurance policy in respect of which an amount is required to be included in a taxpayer’s income under the life insurance accrual rules in subsection 12.2(1) or (5) of the Act. Section 205 of the Regulations requires that a return in respect of a calendar year be filed with the Minister of National Revenue by the last day of February of the year following that year.

New subsection 201(5.1) of the Regulations limits an insurer’s obligations under subsection 201(5) in respect of LIA policies. For further information, see the commentary on the definition “LIA policy” in subsection 248(1) of the Act.

An insurer is required to make a return under subsection 201(5) in respect of an LIA policy only if either:

- the insurer is notified in writing – before the end of the calendar year – that the policy is an LIA policy; or
- it is reasonable to conclude that the insurer knew, or ought to have known, before the end of the calendar year, that the policy is an LIA policy.

The notice requirement is met whether the notice is given by the policyholder or by another party acting on behalf of the policyholder.

This amendment applies to taxation years that end after March 20, 2013.

Clause 57

Exempt policies

ITR

306

Section 12.2 of the Act provides for accrual taxation rules in respect of income earned in life insurance policies. Certain life insurance policies, including policies referred to as “exempt policies”, are excluded from this accrual requirement. Section 306 of the Regulations contains rules for determining if a life insurance policy is an exempt policy.

ITR

306(1)

The preamble to subsection 306(1) of the Regulations is amended to ensure that an LIA policy is not considered an exempt policy. For further information, see the commentary on the definition “LIA policy” in subsection 248(1) of the Act.

This amendment applies to taxation years that end after March 20, 2013.

Clause 58

Elections

ITR

600

Section 600 of the Regulations prescribes provisions of the Act for the purposes of obtaining permission to amend, revoke or extend the time to file an election, for which ministerial discretion may be exercised under paragraphs 220(3.2)(a) and (b) of the Act.

Paragraph 600(b) is amended to add a reference to subsection 251.2(6), consequential on the enactment of the loss restriction event rules in new section 251.2 of the Act. For further information, please see the commentary on section 251.2 of the Act.

This amendment comes into force on March 21, 2013.

Clause 59

Capital cost allowance rates

ITR

1100(1)(a)(xxvii.2)

Subsection 1100(1) of the Regulations sets out the capital cost allowance (CCA) rates that taxpayers may claim with respect to prescribed classes of depreciable property.

Subsection 1100(1) is amended by adding new subparagraph (a)(xxvii.2) to provide a 25% CCA rate for the new Class 41.2 in Schedule II to the Regulations. The new class generally applies to mining property acquired after March 20, 2013.

This amendment applies to taxation years that end after March 20, 2013.

Additional allowances – Class 28 – single mine properties

ITR

1100(1)(w)(i)

Subparagraph 1100(1)(w)(i) of the Regulations is amended to add references to new paragraphs 1100(1)(y.2) and (ya.2).

This amendment applies to taxation years that end after March 20, 2013.

Additional allowances – Class 28 – multiple mine properties

ITR

1100(1)(x)(i)

Subparagraph 1100(1)(x)(i) of the Regulations is amended to add a reference to new paragraph 1100(1)(ya.2).

This amendment applies to taxation years that end after March 20, 2013.

Additional allowances – Class 41 – single mine properties

ITR

1100(1)(y)(i)

Subparagraph 1100(1)(y)(i) of the Regulations is amended to add a reference to new paragraph 1100(1)(ya.2).

This amendment applies to taxation years that end after March 20, 2013.

Additional allowances – Class 41.1 – single mine properties

ITR

1100(1)(y.1)(i)

Subparagraph 1100(1)(y.1)(i) of the Regulations is amended in two respects. First, references to new paragraphs 1100(1)(y.2) and (ya.2) are added. Second, the description of B in the formula in the paragraph is amended by adding new subparagraph (vi). Subparagraph (vi) ensures the proper operation of the formula in the paragraph by prescribing 0% as the applicable percentage if one or more days in the taxation year are after 2014.

This amendment applies to taxation years that end after March 20, 2013.

Additional allowances – Class 41.1 – single mine properties

ITR

1100(1)(y.2)

New paragraph 1100(1)(y.2) of the Regulations is added consequential on the introduction of new Class 41.2 in Schedule II to the Regulations. The paragraph provides for the gradual phase-out of the accelerated capital cost allowance (CCA), during the period 2016 to 2021, applicable to mining property that is a single mine property and for which a separate class is prescribed by new subsection 1101(4g).

Under current rules, accelerated CCA is available in the form of an additional allowance which supplements the regular 25% CCA rate. It allows a taxpayer to deduct, in computing income for a taxation year, up to 100% of the undepreciated capital cost of the mining properties included in the separate Class 41, not exceeding the taxpayer's income for the year from the mine (after deducting regular CCA).

Mining property acquired after March 20, 2013 is generally included in new CCA Class 41.2. New subsection 1101(4g) prescribes a separate class for single mine properties (other than oil sands properties) that are included in paragraph (a) of Class 41.2. Properties included in paragraph (a) of new Class 41.2 remain eligible for the accelerated CCA until 2016. Beginning with 2017, the accelerated CCA is phased out and the amount of the additional allowance will be reduced each year, regardless of whether the constraint is the income from the mine or the amount of the undepreciated

capital cost. The percentage allowed, as accelerated CCA, for each calendar year will be: 90% for 2017, 80% for 2018, 60% for 2019 and 30% for 2020 of the amount otherwise allowable as accelerated CCA. No accelerated CCA will be allowed after 2020 and only the regular 25% CCA rate will apply after 2020.

This amendment applies to taxation years that end after March 20, 2013.

Additional allowances – Class 41.1 – multiple mine properties

ITR

1100(1)(*ya.1*)

Subparagraph 1100(1)(*ya.1*)(i) of the Regulations is amended in two respects. First, a reference to new paragraph 1100(1)(*ya.2*) is added. Second, the description of B in the formula in the paragraph is amended by adding new subparagraph (vi). Subparagraph (vi) ensures the proper operation of the formula in the paragraph by prescribing 0% as the applicable percentage if one or more days in the taxation year are after 2014.

This amendment applies to taxation years that end after March 20, 2013.

Additional allowances – Class 41.2 – multiple mine properties

ITR

1100(1)(*ya.2*)

New paragraph 1100(1)(*ya.2*) of the Regulations is added consequential on the introduction of new Class 41.2 in Schedule II to the Regulations. This paragraph provides for the gradual phase-out of the accelerated capital cost allowance (CCA), during the period 2016 to 2021, applicable to mining property (other than an oil sands property) that is a multiple mine property and for which a separate class is prescribed by new subsection 1101(4h).

Under current rules, accelerated CCA is available in the form of an additional allowance which supplements the regular 25% CCA rate. It allows a taxpayer to deduct, in computing income for a taxation year, up to 100% of the undepreciated capital cost of the properties included in the separate Class 41, not exceeding the taxpayer's income for the year from the mine (after deducting regular CCA).

Mining property acquired after March 20, 2013 is generally included in new CCA Class 41.2. New subsection 1101(4h) prescribes a separate class for multiple mine properties that are included in paragraph (a) of Class 41.2. Properties included in paragraph (a) of new Class 41.2 remain eligible for the accelerated CCA until 2016. Beginning with 2017, the accelerated CCA is phased out and the amount of the additional allowance will be reduced each year, regardless of whether the constraint is the income from the multiple mines or the amount of the undepreciated capital cost. The percentage allowed, as accelerated CCA, for each calendar year will be: 90% for 2017, 80% for 2018, 60% for 2019 and 30% for 2020 of the amount otherwise allowable as accelerated CCA. No accelerated CCA will be allowed after 2020 and only the regular 25% CCA rate will apply after 2020.

This amendment applies to taxation years that end after March 20, 2013.

Clause 60**Separate classes – businesses and properties**

ITR

1101

Section 1101 of the Regulations provides separate classes in respect of certain properties that are described in Schedule II to the Regulations and used to earn income. Section 1101 is amended to introduce new subsections 1101(4g) and (4h).

Single mine property – Class 41.2

ITR

1101(4g)

New subsection 1101(4g) of the Regulations provides for a separate class for single mine properties that are included in paragraph (a) of new Class 41.2 in Schedule II to the Regulations.

This amendment applies to taxation years that end after March 20, 2013.

Multiple mine property – Class 41.2

ITR

1101(4h)

New subsection 1101(4h) of the Regulations provides for a separate class for multiple mine properties that are included in paragraph (a) of new Class 41.2 in Schedule II to the Regulations.

This amendment applies to taxation years that end after March 20, 2013.

Clause 61**Special property rules****Electrical plant used for mining**

ITR

1102(8) and (9)

Paragraphs 1102(8)(d) and (9)(d) of the Regulations allow certain taxpayers to elect to have property that would otherwise be included in Class 41 in Schedule II to the Regulations to instead be included in Class 43.1 or 43.2, as the case may be. These paragraphs are amended to add a reference to new Class 41.2. These amendments apply to property acquired after March 20, 2013.

The coming-into-force provisions for these amendments provide that the election referred to in paragraph 1102(8)(d) or (9)(d), made by a taxpayer in respect of an eligible mine development property (as defined in subsection 1104(2)), or a property described in the new Class 41.2, is deemed to have been filed in the manner described in the paragraphs for the taxation year in which the property was acquired if the election is filed with the Minister in writing on or before the day that is 180 days after the day on which this provision receives Royal Assent. This ensures that, where a taxpayer has acquired property after March 20, 2013 and before the day this provision receives Royal Assent, the taxpayer has at least 180 days to make the election referred to in the paragraphs.

Property acquired by transfer, amalgamation or winding-up

ITR

1102(14)

Subsection 1102(14) of the Regulations ensures that properties acquired by a taxpayer under certain circumstances remain properties of the same class as that of the person from whom the taxpayer acquired the property.

Subsection 1102(14) is amended to add a reference to new subsection (14.12) to ensure that, if applicable, the new rule in subsection 1102(14.12) supersedes the rule in subsection 1102(14).

This amendment applies to property acquired after March 20, 2013.

ITR

1102(14.12)

New subsection 1102(14.12) of the Regulations is introduced to ensure that the undepreciated capital cost (UCC) pool of a mining property (other than an oil sands property) included in Class 41 is preserved, for the purpose of deducting an additional capital cost allowance (CCA) under the Regulations, in circumstances where subsection 1102(14) applies.

Generally, a mining property acquired after March 20, 2013 is to be included in new Class 41.2. Subsection 1102(14.12), however, ensures that where a Class 41 property is acquired in circumstances to which subsection 1102(14) applies, the additional accelerated CCA will continue to be available to the extent of the UCC pool of the vendor.

Paragraph 1102(14.12)(a) provides for a rollover of the reduction in the UCC of Class 41 of the vendor to the UCC of Class 41 of the purchaser. Paragraph 1102(14.12)(b) provides that the amount by which the reduction in the UCC of Class 41 of the vendor exceeds the opening UCC balance of the vendor is to be included in Class 41.2 of the purchaser.

The accelerated CCA in the form of an additional allowance supplements the regular CCA rate for Class 41 property. The additional allowance allows a taxpayer to deduct in computing income for a taxation year up to 100% of the UCC of the properties included in the separate Class 41, not exceeding the taxpayer's income for the year from the mine (after deducting regular CCA).

The accelerated CCA is available in full until 2016 for property included in paragraph (a) of Class 41.2. After 2016, the accelerated CCA is gradually phased out during the 2017-2020 period. The percentage allowed for each of those calendar years will be: 90% for 2017, 80% in 2018, 60% in 2019 and 30% in 2020 of the amount otherwise allowable as accelerated CCA. No accelerated CCA will be allowed after 2020 and only the regular 25% CCA rate will apply after 2020.

This amendment applies to property acquired after March 20, 2013.

Clause 62

Capital cost allowance – interpretation

ITR

1104

Section 1104 of the Regulations sets out various definitions that apply for the purpose of determining the capital cost allowance (CCA) for a taxation year in respect of a depreciable property of a taxpayer.

Section 1104 is amended consequential on the introduction of Class 41.2 in Schedule II to the Regulations applicable to mining property acquired after March 20, 2013, and consequential on the amendments made to Classes 43.1 and 43.2 to expand Class 43.2 by making biogas production equipment that uses more types of organic waste eligible for inclusion in Class 43.2 and to expand the range of cleaning and upgrading equipment that can be used to treat eligible gases.

Definitions

ITR

1104(2)

Subsection 1104(2) of the Regulations sets out definitions that apply for the purposes of Part XI of the Regulations and Schedule II to the Regulations.

Subsection 1104(2) is amended to add the definition “eligible mine development property”. The definition is relevant for the phase-out of accelerated CCA for property used in mining projects (other than oil sands projects) and the consequential introduction of Class 41.2. Eligible mine development property can be included in Class 41 rather than in the new Class 41.2 (i.e., accelerated CCA continues to be available, without any phase-out, in respect of eligible mine development property acquired by a taxpayer after March 20, 2013 and before 2018).

This phase-out of accelerated CCA does not apply to the property used in an oil sands project. The accelerated CCA for oil sands property is already being phased-out based on the schedule set out in the Budget 2007 amendments to subsection 1104(2).

Eligible mine development property means a property acquired by a taxpayer for the purpose of gaining or producing income

- from a new mine or an expansion of a mine, if the property was acquired under a written agreement entered into by the taxpayer before March 21, 2013,
- from a new mine, if either the construction of the new mine or the engineering and design work for the construction of the new mine was started by, or on behalf of, the taxpayer before March 21, 2013, or
- from an expansion of a mine, if either the construction for the expansion of the mine or the engineering and design work for the construction of the expansion of the mine was started by, or on behalf of, the taxpayer before March 21, 2013.

For the purposes of this definition neither construction nor engineering and design work include obtaining permits or regulatory approvals, conducting environmental assessments, community consultations or impact benefit studies, and similar activities. In addition evidence in support of the initiation of the engineering and design work for the construction must be in writing.

This definition comes into force on March 21, 2013.

Mining

ITR

1104(5)

Subsection 1104(5) of the Regulations describes the expression “income from a mine” or any expression referring to a taxpayer’s income from a mine.

Subsection 1104(5) is amended to add references to new paragraphs 1100(1)(y.2) and (ya.2), to new subsections 1101(4g) and (4h), and to the new Class 41.2 in Schedule II to the Regulations. This ensures that the description of the expression “income from a mine” or any expression referring to a taxpayer’s income from a mine in subsection 1104(5) also apply for the purposes of these new provisions.

This amendment comes into force on March 21, 2013.

Gross revenue from a mine

ITR

1104(5.1)

Subsection 1104(5.1) of the Regulations describes the expression “gross revenue from a mine” for the purposes of Classes 41 and 41.1 of Schedule II to the Regulations.

Subsection 1104(5.1) is amended by adding a reference to new Class 41.2. This ensures that the description of the expression “gross income from a mine” in subsection 1104(5.1) applies for the purposes of the new Class 41.2.

This amendment comes into force on March 21, 2013.

Mine

ITR

1104(7)

Subsection 1104(7) of the Regulations describes a mine for certain provisions of the Regulations.

Subsection 1104(7) is amended to add references to new paragraphs 1100(1)(y.2) and (ya.2), to new subsections 1101(4g) and (4h), and to new Class 41.2 in Schedule II to the Regulations. This ensures that the description of a mine also applies for the purposes of these new provisions.

This amendment comes into force on March 21, 2013.

Production

ITR

1104(8.1)

Subsection 1104(8.1) of the Regulations clarifies that any reference to the word “production” means – for the purposes of paragraphs (c) and (e) of Class 28 and paragraph (a) of Classes 41 and 41.1 in Schedule II to the Regulations – production in reasonable commercial quantities.

Subsection 1104(8.1) is amended to add a reference to new Class 41.2. This ensures that for the purposes of new Class 41.2 production also means production in reasonable commercial quantities.

This amendment comes into force on March 21, 2013.

Classes 43.1 and 43.2 – energy conservation property

ITR

1104(13)

Subsection 1104(13) of the Regulations sets out various definitions that apply for the purposes of Class 43.1 (30% CCA rate per year on a declining balance basis) and Class 43.2 (50% CCA rate on a declining balance basis) in Schedule II to the Regulations. The biogas production equipment that is

currently included in Class 43.2 is limited to equipment using organic waste that is sludge from an eligible sewage treatment facility, food and animal waste, manure, plant residue or wood waste.

Subsection 1104(13) is amended in three respects. First, the definition “biogas” is amended to add references to pulp and paper by-product and separated organics. Second, the definition “food and animal waste” is amended to add references to beverages. Third, new definitions of “pulp and paper by-product” and “separated organics” are introduced. These amendments provide that pulp and paper by-product, beverage industry waste (including wastewater) and separated organics from municipal waste can be used in qualifying biogas production equipment described in paragraph (b) of Class 43.2 because they are described in subparagraph (d)(xiii) of Class 43.1.

These amendments generally apply in respect of property acquired after March 20, 2013 that has not been used or acquired for use before March 21, 2013. The new definitions “pulp and paper by-product” and “separated organics” come into force on March 21, 2013.

Clause 63

Investment tax credits

ITR

Part XLVI

Part XLVI of the Regulations provides rules that are generally applicable for the purposes of various definitions in subsection 127(9) of the Act. The definitions in subsection 127(9) of the Act are relevant for the purposes of the investment tax credit regime. Section 4600 is amended to add references to new Class 41.2 in Schedule II to the Regulations.

Qualified property

ITR

4600(1)(b)

Subsection 4600(1) of the Regulations sets out what is a prescribed building for the purposes of the definition “qualified property” in subsection 127(9) of the Act. The cost of a qualified property is included in the definition “investment tax credit” in subsection 127(9) of the Act. A deduction may be claimed, under subsection 127(5) of the Act, in respect of an investment tax credit against tax otherwise payable by a taxpayer.

Paragraph 4600(1)(b) is amended to add a reference to new Class 41.2 in Schedule II to the Regulations.

This amendment applies to property acquired after March 20, 2013.

ITR

4600(2)(j)

Subsection 4600(2) of the Regulations prescribes machinery and equipment for the purposes of the definition “qualified property” in subsection 127(9) of the Act. The cost of a qualified property is included in the definition “investment tax credit” in subsection 127(9) of the Act. A deduction may be claimed, under subsection 127(5) of the Act, in respect of an investment tax credit against tax otherwise payable by a taxpayer.

Paragraph 4600(2)(j) is amended to add a reference to new Class 41.2 in Schedule II to the Regulations.

This amendment applies to property acquired after March 20, 2013.

Clause 64

Prescribed labour-sponsored venture capital corporation

ITR

6701.1

Section 6701 of the Regulations prescribes, for certain purposes of the Act, that corporations that are established or registered under certain provincial statutes, or are registered under section 204.81 of the Act, will be considered “prescribed labour-sponsored venture capital corporations” (prescribed LSVCCs).

New section 6701.1 is added, concurrent with the phase-out of the labour-sponsored funds tax credit and the amendment of section 204.81 of the Act, to prevent a corporation that has not submitted its application for registration under one of the provincial statutes listed in section 6701 prior to March 21, 2013 from qualifying as a prescribed LSVCC for the purposes of the labour-sponsored funds tax credit.

New section 6701.1 comes into force on March 21, 2013.

Clauses 65 to 68

Capital cost allowance – prescribed classes

ITR

Schedule II

Schedule II to the Regulations lists the properties that can be included in each capital cost allowance (CCA) class. A portion of the capital cost of depreciable property is deductible as CCA each year. CCA rates for each type of property, identified by their CCA classes, are set out in section 1100 of the Regulations.

Class 10 (30% rate)

The mid-amble in Class 10 (30% CCA rate) in Schedule II to the Regulations that is after paragraph (f.2) and before paragraph (g) is amended to add a reference to new Class 41.2.

This amendment applies to property acquired after March 20, 2013.

Class 41 (25% rate)

The pre-amble to Class 41 (25% CCA rate) in Schedule II to the Regulations is amended to add a reference to new Class 41.2. This amendment ensures that Class 41 does not apply to mining property included in Class 41.2. Class 41.2 only applies to property that would otherwise be included in paragraph (a) or (a.1) of Class 41, if the property was acquired before March 21, 2013. Eligible mine development property acquired after March 20, 2013 and before 2018 can be included in Class 41. Property that is generally not eligible for accelerated CCA (i.e., property described in paragraphs (a.3) to (d)) of Class 41 will also continue to be included in Class 41. Paragraph (a.2) of Class 41 applies only in respect of oil sands property. The accelerated CCA for oil sands property is already being phased-out based on the schedule set out in the Budget 2007 amendments to subsection 1104(2).

This amendment generally applies to property acquired after March 20, 2013.

Class 41.2 (25% rate)

New Class 41.2 (25% CCA rate) in Schedule II to the Regulations includes mining property acquired after March 20, 2013, other than oil sands property or eligible mine development property. Paragraph (a) of Class 41.2 includes mining property acquired after March 20, 2013 and before 2021 that, if the property had been acquired before March 21, 2013, would have been included in paragraph (a), (a.1) or (a.2) of Class 41. Paragraph (b) of Class 41.2 includes mining property acquired after 2020 that, if the property had been acquired before March 21, 2013, would have been included in paragraph (a), (a.1) or (a.2) of Class 41.

Under current rules, accelerated CCA is available in the form of an additional allowance which supplements the regular 25% CCA rate. It allows a taxpayer to deduct, in computing income for a taxation year, up to 100% of the undepreciated capital cost of the properties included in the separate Class 41, not exceeding the taxpayer's income for the year from the mine (after deducting regular CCA).

As discussed in the commentary on new subsections 1101(4g) and (4h), these subsections prescribe separate classes for certain properties that are included in paragraph (a) of Class 41.2. These separate classes of properties remain eligible for the full accelerated CCA until 2016. Beginning with 2017, accelerated CCA is phased out and the amount of the additional allowance will be reduced each year, regardless of whether the constraint is the level of project income or the amount of the undepreciated capital cost. The percentage allowed, as accelerated CCA, in each calendar year will be 90% for 2017, 80% for 2018, 60% for 2019 and 30% for 2020 of the amount otherwise allowable as accelerated CCA. No accelerated CCA will be allowed and only the regular 25% CCA rate will apply for assets in this Class after 2020.

Eligible mine development property acquired after March 20, 2013 and before 2018 can be included in Class 41.

This amendment comes into force on March 21, 2013.

Class 43.1 (30% rate) and 43.2 (50% rate)

Class 43.1 in Schedule II to the Regulations currently provides an accelerated CCA rate of 30% per year (on a declining balance basis) for certain clean energy generation and energy conservation equipment. Class 43.2 provides an accelerated CCA rate of 50% per year (on a declining balance basis) for property included in that Class. In general, Class 43.2 includes property described in Class 43.1 that is acquired on or after February 23, 2005 and before 2020. Unlike Class 43.1, however, Class 43.2 applies to co-generation equipment described in paragraphs (a) to (c) of Class 43.1 only if the heat efficiency of fuels used in the eligible co-generation system does not exceed a 4,750 BTU requirement (instead of a 6,000 BTU requirement for Class 43.1).

Class 43.1 (and indirectly Class 43.2) is amended to expand Class 43.2 with respect to the biogas equipment and equipment used to treat eligible gases from waste to produce biomethane that is eligible for inclusion in those classes.

ITR

Class 43.1 (d)(viii)

Subparagraph (d)(viii) of Class 43.1 in Schedule II to the Regulations currently describes equipment used primarily for the purpose of collecting and storing landfill gas or digester gas. Biomethane can be obtained by cleaning and upgrading landfill gas or digester gas. The equipment described in

subparagraph (d)(viii) also includes ancillary equipment used to remove non-combustibles and contaminants from landfill gas or digester gas.

Subparagraph (d)(viii) is amended to expand the range of cleaning and upgrading equipment that can be used to treat eligible gases from waste by replacing the reference to “other ancillary equipment” with “related equipment,” as that reference applies to the equipment used to collect, store, clean or upgrade landfill or digester gas.

This amendment applies in respect of property acquired after March 20, 2013 that has not been used or acquired for use before March 21, 2013.

ITR

Class 43.1 (d)(xiii)

Subparagraph (d)(xiii) currently describes property that is part of a system that is used primarily to produce and store biogas. The property described in subparagraph (d)(xiii) includes equipment that is an anaerobic digester reactor, a buffer tank, a pre-treatment tank, biogas piping, a biogas storage tank and a biogas scrubbing equipment. Biomethane can be obtained by cleaning and upgrading biogas. The equipment described in subparagraph (d)(xiii) only includes biogas scrubbing equipment and does not include any other equipment that can be used to remove non-combustibles and contaminants from biogas.

Subparagraph (d)(xiii) is amended to expand the range of cleaning and upgrading equipment that can be used to treat eligible gases from waste by replacing the reference to “biogas scrubbing equipment” with “equipment used to remove non-combustibles and contaminants from the gas”. In addition the list of equipment that can be included in subparagraph (d)(xiii) is expanded to include fans, compressors and heat exchangers.

This amendment applies in respect of property acquired after March 20, 2013 that has not been used or acquired for use before March 21, 2013.

Part 2

Amendments to the Excise Tax Act

Clause 69

Electronic Suppression of Sales – Administrative Monetary Penalties

ETA

285.01

New section 285.01 of the *Excise Tax Act* (the Act) provides for administrative monetary penalties in relation to electronic suppression of sales software or devices that are, or are intended to be, capable of being used in relation to records that are required to be kept under section 286 of the Act. These new penalties are in addition to other penalties that may be assessed under the Act.

New section 285.01 comes into force on the later of January 1, 2014 and the day of Royal Assent to the enacting legislation.

Definitions

ETA

285.01(1)

New subsection 285.01(1) defines the terms “electronic cash register” and “electronic suppression of sales device” for the purposes of section 285.01.

“electronic cash register”

New definition “electronic cash register” generally means an electronic device or computer system designed to record transaction data or any other electronic point-of-sale system.

“electronic suppression of sales device”

New definition “electronic suppression of sales device” (ESS device) generally means a software program that falsifies the records of electronic cash registers or a hidden programming option in an electronic cash register that may be used to create a virtual second till or to eliminate or manipulate transaction records in the electronic cash register.

Penalties

ETA

285.01(2), (3) and (4)

New subsection (2) imposes a penalty on every person that uses an ESS device or a similar device or software or that under circumstances attributable to neglect, carelessness or wilful default, participates in, assents to or acquiesces in the use of an ESS device or similar device or software. New subsection (3) imposes a penalty on every person that acquires or possesses an ESS device or a right in respect of an ESS device. On the first penalty in relation to the use, acquisition or possession of an ESS device imposed on the person under this Act or the *Income Tax Act*, the amount of the penalty is \$5,000. If the person has already been assessed a penalty in relation to an ESS device under either Act, the penalty for any subsequent use, acquisition or possession by the person of an ESS device is \$50,000.

New subsection (4) imposes a penalty on every person that designs, develops, manufactures, sells, possesses for sale, offers for sale, transfers or otherwise makes available an ESS device or that supplies installation, upgrade or maintenance services for an ESS device. On the first penalty in

relation to the manufacturing or making available of an ESS device imposed to the person under this Act or the *Income Tax Act*, the amount of the penalty is \$10,000, if the person has not already been assessed a penalty in relation to an ESS device under either Act. If it is the first penalty in relation to the manufacturing or making available of an ESS device, but another penalty in relation to the use, acquisition or possession of an ESS device has previously been assessed under either Act, the amount of the penalty is \$50,000. If a penalty in relation to the manufacturing or making available of an ESS device has previously been assessed to the person under either Act, the amount of the penalty is \$100,000.

Limitation

ETA

285.01(5)

New subsection (5) provides a limitation with respect to the assessment of multiple penalties under this section. This subsection provides that if the Minister assesses a penalty under this section, the Minister is not to assess another penalty payable by the person in respect of an action that relates to an ESS device that occurred before that penalty was assessed.

Due Diligence

ETA

285.01(6) and (7)

New subsection (6) provides that, unless specifically provided by new subsection (7), a due diligence defence is not available in relation to penalties imposed under section 285.01.

New subsection (7) provides that, in the case of penalties imposed under new subsections (3) and (4), a person is not liable in respect of an action of the person if the person exercised the degree of care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances to prevent that action from occurring.

Assessment Vacated

ETA

285.01(8)

New subsection (8) provides that, for the purposes of new section 285.01, if an assessment of a penalty under this section is vacated, the penalty is deemed to have never been assessed. This would mean, for example, that if an assessment of a penalty is vacated, that assessment would no longer trigger the limitation provided for in new subsection (5).

Clause 70

Period for Assessment

ETA

298(1)(e)

Subsection 298(1) of the Act sets out the limitation periods for assessments and reassessments of amounts under Part IX of the Act. Paragraph 298(1)(e) establishes that if a person is liable to pay a penalty, other than a penalty under sections 280, 285 or 285.1 of the Act, the person may not be assessed in respect of the penalty more than four years from when the person became liable.

The amendment to paragraph 298(1)(e) adds a reference to the new penalty imposed under new section 285.01 of the Act in the list of provisions not subject to the limitation period provided for in this paragraph.

The amendment comes into force on the later of January 1, 2014 and the day of Royal Assent to the enacting legislation.

Clause 71

Electronic Suppression of Sales – Offences

ETA

327.1

New section 327.1 of the Act sets out offences in relation to electronic suppression of sales software or devices that are, or are intended to be, capable of being used in relation to records that are required to be kept under section 286 of the Act.

New section 327.1 comes into force on the later of January 1, 2014 and the day of Royal Assent to the enacting legislation.

Definitions

ETA

327.1(1)

New subsection 327.1(1) provides that the definitions in subsection 285.01(1) of the Act apply in section 327.1. For more information, refer to the commentary for new subsection 285.01(1).

Offences

ETA

327.1(2) to (5)

New subsection 327.1(2) provides that every person is guilty of an offence if that person, without lawful excuse, the proof of which lies on the person,

- a) uses an ESS device or a similar device or software in relation to records that are required to be kept under section 286 of the Act,
- b) acquires or possesses an ESS device, or a right in respect of an ESS device, that is, or is intended to be, capable of being used in relation to records that are required to be kept under section 286,
- c) designs, develops, manufactures, possesses for sale, offers for sale, sells, transfers or otherwise makes available to another person an ESS device that is, or is intended to be, capable of being used in relation to records that are required to be kept under section 286,
- d) supplies installation, upgrade or maintenance services for an ESS device that is, or is intended to be, capable of being used in relation to records that are required to be kept under section 286, or
- e) participates in, assents to or acquiesces in the commission of, or conspires with any person to commit any of the offences described above.

In addition to any penalty otherwise provided, the person is liable on summary conviction, to a fine of not less than \$10,000 and not more than \$500,000, or to imprisonment for a term not exceeding two years, or to both.

New subsection (3) provides that, in respect of the offences described in subsection (2), the Attorney General of Canada may proceed by indictment. If convicted, the person is liable to a fine of not less than \$50,000 and not more than \$1,000,000, or to imprisonment for up to five years, or to both.

New subsection (4) provides that if a person is convicted of an offence under this section, the person will not be liable to pay a penalty under any of sections 280.1, 280.11 and 283 to 285.1 of the Act for the same action that led to the conviction. This rule will not apply, however, if a notice of assessment in respect of the penalty was issued before the information or complaint giving rise to the conviction was laid or made.

New subsection (5) provides that the Minister may stay an appeal under Part IX of the Act pending the determination of a prosecution under this section where substantially the same facts are at issue in both instances.

New section 327.1 comes into force on the later of the day on which the enacting legislation receives royal assent and January 1, 2014.

Clause 72

Supplies All or Substantially All for No Consideration

ETA

Sch. V, Pt. VI, section 10

Section 10 of Part VI of Schedule V to the Act exempts supplies by a public sector body of property or services if all or substantially all of the body's supplies of the property or service are made for no consideration. Such supplies are not considered to be made in the course of a commercial activity. The supply of blood and blood derivatives is excluded from the exemption as these supplies are zero-rated under Part I of Schedule VI to the Act.

Section 10 of Part VI of Schedule V is amended to also expressly exclude from exemption supplies of parking spaces if the supply of a parking space is made for consideration, by way of lease, licence or similar arrangement and in the course of a business carried on by the public sector body.

The amendment clarifies that section 10 of Part VI of Schedule V does not apply to supplies of commercial paid parking by a public sector body even if the body provides a significant amount of parking at no charge.

The amendment is effective December 17, 1990, the date when section 10 was originally enacted.