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CHANGES PROPOSED TO EXPENDITURES RELATED TO TAX SHELTERS

Secretary of State (Finance) Doug Peters today tabled in the House of Commons a Notice of Ways and Means Motion proposing changes to the *Income Tax Act* that affect transactions under which investors achieve tax-shelter benefits by financing the business expenses of other taxpayers in exchange for a right to receive future income. These tax shelter arrangements evolved out of provisions of general application in the *Income Tax Act* and were never intended as a “tax-assisted” investment incentive.

The proposed measures restrict the deductibility of these expenditures by prorating them over the economic life of the related right to receive future income.

“These measures are designed to protect the personal and corporate tax bases,” Mr. Peters said.

A backgrounder explaining the proposals in more detail is attached. The Notice of Ways and Means Motion and explanatory notes are also provided in the attached annex. References to “announcement date” should be read as referring to today's date.

For further information:

Department of Finance
Kerry Harnish
Tax Policy Officer
Tax Legislation Division
(613) 992-4385

Revenue Canada
Marc Vanasse
Section Chief
Rulings Directorate
(613) 957-8978

BACKGROUNDER

Transactions under which businesses finance their operations through tax-assisted financing arrangements have grown in utilization because they provide businesses with financing that is partially subsidized by the government, that is off-balance sheet in nature and that provides investors with valuable tax-deferral benefits. The measures announced today do not preclude structures in which third parties invest in another person's business. Rather, these measures constrain the tax-assistance in such structures by matching the cost of an investor's investment to the periods during which the investment earns income. In this way, investors cannot create losses in the early years of an investment that off-set income from other sources and which would otherwise be subject to tax.

Transactions of the type affected by the amendments involve the financing of business expenses by selling those expenses to investors who derive tax shelter benefits. In these transactions, investors undertake to pay expenditures that would otherwise be expenses payable by the "vendor" (e.g., payroll, selling commissions) in exchange for a right to receive future income, usually from the vendor's operation. Many of the taxpayers that sell their expenses do so because they are not in a tax paying position (e.g., they are incurring losses) and do not need the expenses to offset taxable income, or to achieve off-balance sheet financing which, effectively, raises funds without the amounts raised showing up as debt on the balance sheet.

The reasons why third party investors are willing to assume these expenditures include the valuable tax deferral benefits that can be obtained. In this regard, the third party's expenditure is written-off much sooner than the income from the right is realized. That is to say, for the purpose of computing accounting income the principle of conservatism[1] may operate to shorten the period over which an expenditure related to a right to receive income would otherwise be amortized under the matching[2] principle.

[1] From the perspective of computing income, the expensing (in an accounting sense) of an expenditure to an income period as soon as is reasonable while revenue is not recognized until the income period in which it is reasonably certain. Note: this footnote is for information purposes only and should not be considered to be a definition for the purposes of interpreting accounting principles or the tax law.

[2] From the perspective of computing income, the apportionment of the cost of an expenditure to the income period or periods in which resulting income is recognized (i.e., the expensing of the expenditure in an accounting sense). Note: this footnote is for information purposes only and should not be considered to be a definition for the purposes of interpreting accounting principles or the tax law.

These transactions give rise to uncertainty as to whether such expenditures are deductible for tax purposes and, if so, the appropriate matching period. Where the expenditures are deductible under the established tax jurisprudence, there is a mismatching of expenses and revenue to the extent that the portion of the expenditure deducted by a taxpayer in an early taxation year(s) exceeds revenue recognized from the right in the year(s) with the excess deduction being applied against other sources of income which would otherwise be taxable. This creates a tax shelter under which investors defer their tax liabilities. In effect, the value of the tax loss is being used to subsidize the financing of the vendor's business expenses.

Recently there has been increased pressure for transactions of this type to be applied to a broad range of businesses which would, if permitted, have significant revenue implications for the government. In response, Finance Minister Paul Martin has proposed new measures designed to restrict the deductibility of an otherwise deductible "matchable expenditure" related to a "right to receive production" by prorating the deductibility of the amount of the expenditure over the economic life of the right.

ANNEX

Notice of Ways and Means Motion to amend the Income Tax Act

That it is expedient to amend the Income Tax Act as follows:

INCOME TAX ACT

1.(1) Subsection 12(1) of the Income Tax Act is amended by adding, immediately after paragraph (g), the following:

Proceeds of disposition of right to receive production

(g.1) any proceeds of disposition to which subsection 18.1(6) applies;

(2) Subsection 1(1) applies to dispositions that occur after <u>Announcement Date - 1 day</u>.

2.(1) The Act is amended by adding the following after section 18:

Definitions

18.1(1) The definitions in this subsection apply to this section.

"matchable expenditure" of a taxpayer means the amount of an expenditure that is made by the taxpayer to

(a) acquire a *right to receive production*,

(b) fulfil a covenant or obligation arising in circumstances where it is reasonable to conclude that there is a relationship existing between the covenant or obligation and a *right to receive production*, or

(c) preserve or protect a *right to receive production*,

but does not include an amount for which a deduction is provided under section 20 in computing the taxpayer's income.

"right to receive production" means a right under which a taxpayer is entitled, either immediately or in the future and either absolutely or contingently, to receive an amount all or any portion of which is computed by reference to use of property, production, revenue, profit, cash flow, commodity price, cost or value of property or any other similar criterion or by reference to dividends paid or payable to shareholders of any class of shares where the amount is in respect of another taxpayer's activity, property or business, but does not include an income interest in a trust, a Canadian resource property or a foreign resource property.

"taxpayer" includes a partnership.

Limitation on the deductibility of matchable expenditure

(2) In computing a taxpayer's income for a taxation year, no amount of a *matchable expenditure* may be deducted except as provided by subsection (3).

Deduction of matchable expenditure

(3) Where a taxpayer's *matchable expenditure* would but for subsection (2) and this subsection be deductible in computing the taxpayer's income, there may be deducted in respect of the *matchable expenditure* in computing the taxpayer's income for a taxation year the amount that is determined under subsection (4) for the year in respect of the expenditure.

Amount of deduction

(4) For the purpose of subsection (3), the amount determined under this subsection for a taxation year in respect of a taxpayer's *matchable expenditure* is the amount, if any, that is the least of

(a) the total of

(i) the lesser of

(A) 1/5 of the *matchable expenditure*, and

(B) the amount determined by the formula

$$A/B \times C$$

where

A is the number of months that are in the year and after the day on which the *right to receive production* to which the *matchable expenditure* relates is acquired,

B is lesser of 480 and the number of months that are in the period that begins on the day on which the *right to receive production* to which the *matchable expenditure* relates is acquired and ends on the day that right is to terminate, and

C is the amount of the *matchable expenditure*, and

(ii) the amount, if any, by which the amount determined under this paragraph for the preceding taxation year in respect of the *matchable expenditure* exceeds the amount of the *matchable expenditure* deductible in computing the taxpayer's income for that preceding year,

(b) the total of

(i) the total of all amounts each of which is included in computing the taxpayer's income for the year (other than any portion of such amount that is the subject of any reserve claimed by the taxpayer for the year under this Act) in respect of the *right to receive production* to which the *matchable expenditure* relates, and

(ii) the amount by which the amount determined under this paragraph for the preceding taxation year in respect of the *matchable expenditure* exceeds the amount of the *matchable expenditure* deductible in computing the taxpayer's income for that preceding year, and

(c) the amount, if any, by which

(i) the total of all amounts each of which is an amount of the *matchable expenditure* that would, but for this section, have been deductible in computing the taxpayer's income for the year or a preceding taxation year

exceeds

(ii) the total of all amounts each of which is an amount of the *matchable expenditure* deductible under subsection (3) in computing the taxpayer's income for a preceding taxation year.

Rules for subsection (4) amount

(5) For the purpose of subsection (4),

(a) where a taxpayer's *matchable expenditure* is made before the day on which the related *right to receive production* is acquired by the taxpayer, the expenditure is deemed to have been made on that day;

(b) where a taxpayer has one or more rights to renew a particular *right to receive production* to which a *matchable expenditure* relates for one or more additional terms, after the term that includes the time at which the particular right was acquired, the particular right is deemed to terminate on the latest day on which the latest possible such term could terminate if all rights to renew the particular right were exercised; and

(c) where the term of a taxpayer's *right to receive production* is for an indeterminate period, the right is deemed to terminate 480 months after it is acquired.

Proceeds of disposition considered income

(6) Where in a taxation year a taxpayer disposes of all or part of a *right to receive production* to which a *matchable expenditure,* any portion of which is deductible under subsection (3), relates, the proceeds of the disposition shall be included in computing the taxpayer's income for the year.

Arm's length disposition

(7) Where

(a) at any time in a taxation year a taxpayer's *right to receive production* to which a *matchable expenditure* relates expires or the taxpayer disposes of all of the right (otherwise than in a disposition to which subsection 87(1) or 88(1) applies),

(b) after that time no person affiliated with the taxpayer has any interest in the right or any right substituted therefor, and

(c) before that time no taxpayer that has an interest, directly or indirectly, in the right has an interest, directly or indirectly, in another *right to receive production* that can reasonably be considered to relate in any way to the right, the amount determined under subsection (4) for the year in respect of the *matchable expenditure* is deemed to be the amount, if any, determined under paragraph (4)(c) for the year in respect of the *matchable expenditure*.

Application of section 143.2

(8) For the purpose of applying section 143.2 to an amount that would, but for this subsection, be a *matchable expenditure* any portion of which is deductible under subsection (3), the expenditure is deemed to be a tax shelter investment and that section shall be read without reference to subparagraph (6)(b)(ii).

Debt Obligations

(9) Where the rate of return on a taxpayer's *right to receive production* is reasonably certain at the time the taxpayer acquired the right,

(a) the right is, for the purposes of subsection 12(9) and Part LXX of the *Income Tax Regulations*, deemed to be a debt obligation in respect of which no interest is stipulated to be payable in respect of its principal amount and the obligation is deemed to be satisfied at the time the right terminates for an amount equal to the total of the return on the obligation and the amount that would otherwise be the *matchable expenditure* that is related to the right, and

(b) notwithstanding subsection (3), no amount may be deducted in computing the taxpayer's income in respect of any *matchable expenditure* that relates to the right.

(2) Subsection (1) applies to an expenditure made by a taxpayer or a partnership after <u>Announcement Date - 1 day</u> other than such an expenditure made

(a) before 1997 in respect of a particular *right to receive production*, pursuant to an agreement in writing made by the taxpayer or the partnership before 1997 to acquire the particular right to

(i) pay selling commissions incurred before 1997 by a mutual fund corporation or mutual fund trust, or

(ii) render production services before 1997 for a film or video production,

(b) before 1998 in respect of a particular *right to receive production*, pursuant to an agreement in writing made by the taxpayer or the partnership before <u>Announcement Date</u> to acquire the particular right, and for this purpose where the expenditure relates to service obligations to be fulfilled by the taxpayer or partnership, the expenditure is considered to have been made only when and to the extent the services are rendered,

(c) before 1998 in respect of a particular *right to receive production*, pursuant to the terms of a document that is a prospectus, preliminary prospectus or registration statement where

(i) the document was filed before Announcement Date with a public authority in Canada pursuant to and in accordance with the securities legislation of Canada or of any province and, where required by law, accepted for filing by the public authority,

(ii) the particular right is identified in the document, and

(iii) all the funds raised pursuant to the document were raised before 1997,

and for these purposes, where an expenditure relates to service obligations to be fulfilled by the taxpayer or partnership, the expenditure is considered to have been made only when and to the extent the services are rendered, or

(d) before 1998 in respect of a particular *right to receive production*, pursuant to the terms of an offering memorandum distributed as part of an offering of securities where

(i) the memorandum contained a complete or substantially complete description of the securities contemplated in the offering as well as the terms and conditions of the offering,

(ii) the memorandum was distributed before Announcement Date,

(iii) solicitations in respect of the sale of the securities contemplated by the memorandum were made before Announcement Date,

(iv) the sale of the securities was substantially in accordance with the memorandum,

(v) the particular right is identified in the document, and

(vi) all the funds raised pursuant to the memorandum were raised before 1997,

and for these purposes, where an expenditure relates to service obligations to be fulfilled by the taxpayer or partnership, the expenditure is considered to have been made only when and to the extent the services are rendered,

except that paragraphs (b), (c) and (d) apply to an expenditure only if:

(e) there is no agreement or other arrangement under which the obligations of the taxpayer or the partnership with respect to the expenditure can be changed, reduced or waived if there is a change to the Act or if there is an adverse assessment under the Act,

(f) where the expenditure is associated with one or more tax shelters sold or offered for sale at a time and in circumstances in which section 237.1 of the Act requires an identification number to be obtained, an identification number was obtained before that time, and

(g) in the case of an expenditure made pursuant to a document described in paragraph (c) or (d) including such an expenditure to which paragraph (b) applies, a portion of the securities authorized to be sold in 1996 pursuant to the document were in 1996 and before <u>Announcement Date</u> sold to, or subscribed for by, a person who is not

(i) a promoter, or an agent of the promoter, of the securities,

(ii) the grantor of the *right to receive production* to which the expenditure relates,

(iii) a broker or dealer in securities, or

(iv) a person who does not deal at arm's length with a person referred to in subparagraph (i) or (ii).

3.(1) Paragraph 87(2)(j.2) of the Act is replaced by the following:

Prepaid expenses and matchable expenditures

(j.2) for the purposes of subsections 18(9) and (9.01), <u>section 18.1</u> and paragraph 20(1)(mm), the new corporation is deemed to be the same corporation as, and a continuation of each predecessor corporation,

(2) Subsection 3(1) applies after <u>Announcement Date - 1 day</u>.

4.(1) Subparagraph 88(1)(a)(i) of the Act is replaced by the following:

(i) in the case of a Canadian resource property, a foreign resource property <u>or a *right to receive production* (as defined by subsection 18.1(1)) to which a *matchable expenditure* (as defined by subsection 18.1(1)), any portion of which is deductible under subsection 18.1(3), relates</u>, nil, and

(2) Subsection 4(1) applies after <u>Announcement Date- 1 day</u>.

5.(1) Paragraph (e) of the definition "cost amount" in subsection 248(1) of the Act is amended by striking out the word "or" at the end of subparagraph (ii), by adding the word "or" at the end of subparagraph (iii) and by adding the following after subparagraph (iii):

(iv) a *right to receive production* (as defined by subsection 18.1(1)) to which a *matchable expenditure* (as defined in subsection 18.1(1)), any portion of which is deductible under subsection 18.1(3), relates,

(2) Subsection (1) applies after <u>Announcement Date - 1 day</u>.

Matchable Expenditures: Explanatory Notes

Clause 1

Proceeds of disposition of right to receive production

ITA
12(1)(g.1)

Proposed paragraph 12(1)(g.1) of the Act requires a taxpayer to fully include in computing income proceeds from the disposition of a *right to receive production* to which new subsection 18.1(6) of the Act applies. This amendment applies after **Announcement Date - 1 day**.

Clause 2

Matchable Expenditures

ITA
18.1

Proposed 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. The "Backgrounder" accompanying Department of Finance Press Release 96-XXX provides general details about the tax policy concerns that lead to section 18.1 being proposed by the government. The detailed rules in section 18.1 are discussed below. Generally, proposed section 18.1 applies after **Announcement Date - 1 day**.

ITA
18.1(1)

Subsection 18.1(1) provides the definitions of *matchable expenditure*, *right to receive production* and *taxpayer* for the purposes of that section.

ITA
18.1(2) to (4)

Subsection 18.1(2) provides that *matchable expenditures* are deductible only to the extent provided by subsection 18.1(3).

Subsection 18.1(3) provides that a *matchable expenditure* is deductible in computing a taxpayer's income for a taxation year to the extent of the amount that is determined under subsection 18.1(4). However, subsection 18.1(4) does not apply to provide a deduction unless the taxpayer's *matchable expenditure* would otherwise be deductible. The determination of whether an amount that is a taxpayer's *matchable expenditure* would otherwise have been "deductible" in computing the taxpayer's income should be made by reference to the established income tax law.

Subsection 18.1(4) provides rules for determining the amount of a taxpayer's *matchable expenditure* that may be deducted under subsection 18.1(3) if that provision applies. That amount is determined as the least of three amounts.

Generally, the first of those amounts is the expenditure pro-rated over the term of the *right to receive production* to which the expenditure relates, except that in no event is the term used to be less than 5 years. Added to this amount, however, are amounts that would have been deductible in preceding years under this computation but for the second constraint. The second constraint is the amount of income included in computing the taxpayer's income in respect of the right for the year. Added to this amount, however, is income for previous years against which amounts could not be deducted because of the first constraint. The third constraint is the amount that would otherwise have been deductible in computing the taxpayer’s income up to and including the current taxation year in respect of the taxpayer's *right to receive production* minus the amounts deductible under subsection 18.1(3) in computing the taxpayer's income for preceding taxation years. Two examples illustrating the application of these constraints accompany the explanatory note to proposed subsections 18.1(6) and (7).

ITA
18.1(5)

Subsection 18.1(5) of the Act provides three rules that apply for the purpose of determining the amount of a *matchable expenditure* under subsection 18.1(4) to which subsection 18.1(3) may apply. First, if a taxpayer's *matchable expenditure* is actually made before the related *right to receive production* is acquired, the expenditure will be considered to have been made on the day that the right is acquired. Second, if a taxpayer has one or more rights to renew a *right to receive production* for one or more additional terms, the term of the right is to be treated as terminating at the latest possible time that such additional term could terminate if all rights to renew the right were exercised. Third, if the term of a taxpayer's right to *receive production* is for an indeterminate period, the right is considered to terminate 40 years after it is acquired.

ITA
18.1(6) and (7)

Subsection 18.1(6) provides that a taxpayer's proceeds from the disposition of a *right to receive production* are to be included in computing the taxpayer's income.

Subsection 18.1(7) provides a terminal deduction in respect of a taxpayer's *matchable expenditure* if three conditions are met. First, the taxpayer's *right to receive production* to which the *matchable expenditure* relates must expire or all of the right must be disposed of (otherwise than pursuant to an amalgamation or corporate winding-ups to which subsection 87(1) or subsection 88(1) of the Act applies, respectively).

Second, no person affiliated with the taxpayer can have any interest in the right or any right substituted therefor after the time the taxpayer's right expires or is disposed of (for the definition of "affiliated person", see proposed subsection 252.1(1) of the Act included in the Notice of Ways & Means Motion tabled in the House of Commons on June 20, 1996).

Third, before the expiry or disposition of the right, no taxpayer that had an interest in the right can have an interest in another *right to receive production* that can reasonably be considered to relate in any way to the right. For example, this condition precludes Partnership 1 from deducting a terminal amount in respect of a *right to receive production* held by it if another taxpayer that has an interest in the partnership (e.g., Partnership 2) has an interest, directly or indirectly, in another *right to receive production* that can reasonably be considered to relate in any way to the right (e.g., Partnership 3 holds a related right and Partnership 2 has an interest in both Partnerships 1 and 3).

Example 1: Taxpayer Holds Right to Expiry

- Taxpayer A incurs $1,000 of *matchable expenditures* that relate to a *right to receive production* from Taxpayer B's business over a 6-year period (i.e., 25% of the annual gross sales from the sale of a particular product).

- The $1,000 was expended for the purpose of earning income. Taxpayer A has a reasonable expectation of profit from the *right to receive production,* and the amount is otherwise deductible. The deductibility of the *matchable expenditure* is, therefore, provided for by subsection 18.1(3) of the Act (as determined under subsection 18.1(4)).

- Taxpayer A receives the following gross revenue payments from Taxpayer B:

Year 1: $100
Year 2: $200
Year 3: $300
Year 4: $200
Year 5: $100
Year 6: $500

- Taxpayer A's right to receive production expires in year 6 (i.e., subsection 18.1(7) applies in that year).

Calculation of Taxpayer A's Subsection 18.1(3) Deduction:

Year 1: Taxpayer A may deduct **$100** pursuant to subsections 18.1(3) and (4), being the *least* of:

(a): the total of

- the lesser of
  $200 (1/5 x $1,000)
  $167 ($1,000/6)
- Nil

$167

(b): the total of

- $100 (receipts included in income)
- Nil

$100

(c): $200 ($200 - Nil)[1]

Year 2: Taxpayer A may deduct **$200** which is the *least* of:

1 Assuming a 5-year matching period under general principles.

(a): the total of

- the lesser of
  $200 (1/5 x $1,000)
  $167 ($1,000/6)
- $ 67 (year 1: $167[a] - $100[b])
  $234

(b): the total of

- $200 (receipts included in income)
- Nil
  $200

(c): $300 ($400 - $100)

Year 3: Taxpayer A may deduct **$201** which is the *least* of:

(a): the total of

- the lesser of
  $200 (1/5 x $1,000)
  $167 ($1,000/6)
- $ 34 (year 2: $234[a] - $200[b])
  $201

(b): the total of

- $300 (receipts included in income)
- Nil
  $300

(c): $300 ($600 - $300)

Year 4: Taxpayer A may deduct **$167** which is the *least* of:

(a): the total of

- the lesser of

$200 (1/5 x $1,000)
$167 ($1,000/6)

° Nil
$167

(b): the total of

° $200 (receipts included in income)
° $ 99 (year 3: $300[b] - $201[a])
$299

(c): $299 ($800 - $501)

Year 5: Taxpayer A may deduct **$167** which is the *least* of:

(a): the total of

° the lesser of
$200 (1/5 x $1,000)
$167 ($1,000/6)
° Nil
$167

(b): the total of

° $100 (receipts included in income)
° $132 (year 4: $299[b] - $167[a])
$232

(c): $332 ($1,000 - $668)

Year 6: Taxpayer A may deduct **$165** because subsection 18.1(7) applies. The amount otherwise determined under subsection 18.1(4) would have been the *least* of:

(a): the total of

° the lesser of
$200 (1/5 x $1,000)
$167 ($1,000/6)
° Nil
$167

(b): the total of

- $500 (receipts included in income)
- $ 65 (year 5: $232[b] - $167[a])
  $565

(c): **$165** ($1,000 - $835)

SUMMARY

Year	Income	Deductible Portion of Matchable Expenditure	Net Income (loss)
1	$100	$100	Nil
2	$200	$200	Nil
3	$300	$201	$ 99
4	$200	$167	$ 33
5	$100	$167	($67)
6	$500	$165	$335
Total		$1,000	

Example 2: Taxpayer Disposes of Right to Affiliated Person

- Taxpayer A incurs $1,000 of *matchable expenditures* that relate to a *right to receive production* from Taxpayer B's business over a 6-year period (i.e., 25% of the annual gross sales from the sale of a particular product).

- The $1,000 amount was expended for the purpose of earning income, that Taxpayer A has a reasonable expectation of profit from the *right to receive production* and the amount is otherwise deductible (subject to matching) under previously existing jurisprudence. The deductibility of the matchable expenditure is, therefore, provided for by subsection 18.1(3) (as determined under subsection 18.1(4)).

- For years 1 to 4, Taxpayer A receives the following gross revenue payments from Taxpayer B:

  Year 1: $100
  Year 2: $200
  Year 3: $300
  Year 4: $200

- In year 4, and after receiving the $200 from Taxpayer B, Taxpayer A disposes of the *right to receive production* for Nil proceeds to affiliated person C (assume that the transfer of the right occurred at fair market value and that the attribution rules do not apply to any potential receipts that affiliated person C may receive from the right).

- Affiliated person C's acquired *right to receive production* expires at the end of year 6.

Calculation of Taxpayer A's Subsection 18.1(3) Deduction:

Years 1
to 3: See Example 1 above (i.e., Year 1= $100; Year 2=$200; and Year 3=$201).

Year 4: Taxpayer A may deduct **$167** which is the *least* of:

(a): the total of

- the lesser of
  $200 (1/5 x $1,000)
  $167 ($1,000/6)
- Nil
  $167

(b): the total of

- $200 (receipts included in income)
- $ 99 (year 3: $300[b] - $201[a])
  $299

(c): $499 ($1,000 - $501)

Year 5: Taxpayer A may deduct **$132** which is the *least* of:

(a): the total of

- the lesser of
  $200 (1/5 x $1,000)
  $167 ($1,000/6)
- Nil
  $167

(b): the total of

- Nil (receipts included in income)
- $<u>132</u> (year 4: $299[b] - $167[a])

$132

(c): $332 ($1,000 - $668)

Year 6: Taxpayer A may deduct **$200** because subsection 18.1(7) applies to deem the amount determined under subsection 18.1(4)(c) to be the relevant amount for the year notwithstanding that the amount otherwise determined under proposed paragraph 18.1(4)(b) would have been the *least* amount of:

(a): the total of

- the lesser of
  $200 (1/5 x $1,000)
  $167 ($1,000/6)
- <u>$ 45</u> (Year 5: $167[a] - $132[b])

$212

(b): the total of

- Nil
- <u>Nil</u>

Nil

(c): $200 ($1,000 - $800)

SUMMARY

Year	Income	Deductible Portion of Matchable Expenditures	Net Income (loss)
1	$100	$100	Nil
2	$200	$200	Nil
3	$300	$201	$ 99
4	$200	$167	$ 33
5	Nil	$132	($132)
6	Nil	$200	($200)
Total		$1,000	

ITA
18.1(8)

Subsection 18.1(8) provides that a *matchable expenditure* is considered to be a tax shelter investment for the purpose of applying the limited-recourse debt rules in proposed section 143.2 of the Act. For this purpose, however, the limited-recourse debt rules are to be read without reference to the "at-risk adjustment" reductions.

ITA
18.1(9)

Subsection 18.1(9) provides that a *right to receive production* is considered to be a debt obligation to which the accrual rules in Part LXX of the Income Tax Regulations apply if the rate of return on the right is reasonably certain. In such cases, no amount may be deducted under subsection 18.1(3) in respect of any *matchable expenditure* that relates to the right.

Clause 3

Amalgamations
ITA
87(2)(j.2)

Paragraph 87(2)(j.2) of the Act provides that a corporation formed as a result of an amalgamation is considered to be a continuation of its predecessor corporations for the purposes of subsection 18(9) (prepaid expenses), subsection 18(9.01) (premium paid under group life insurance policies) and paragraph 20(1)(mm) (cost of injected substance used to recover petroleum, natural gas or related hydrocarbons). Paragraph 87(1)(j.2) is amended, effective **Announcement Date**, so that it also applies for the purpose of new section 18.1 (i.e., to a *right to receive production* to which a *matchable expenditure* relates).

Clause 4

Windings-Up

ITA
88(1)(a)(i)

Paragraph 88(1)(a) of the Act provides rules for determining the proceeds of disposition of a subsidiary's property a on wind-up to which subsection 88(1) applies. Subparagraph 88(1)(a)(i) is amended to provide nil proceeds of the disposition of a subsidiary's *right to receive production* to which a *matchable expenditure* relates. This effectively results in a rollover of a subsidiary's *right to receive production* to its parent. This subsection applies after **Announcement Date -1 day**.

Clause 5

Definitions

ITA
248(1)

Subparagraph (e)(iv) of the definition of "cost amount" in subsection 248(1) of the Act is amended consequential on the rules that apply to a *right to receive production* to which a *matchable expenditure* relates (both italicized terms are defined in new section 18.1). This subsection applies after **Announcement Date - 1 day**.