Explanatory Notes to Legislation Relating to Income Tax

Published by
The Honourable Paul Martin, P.C., M.P.
Minister of Finance

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Canada

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PREFACE

The legislation to which these explanatory notes relate contains amendments to the *Income Tax Act* and the *Income Tax Application Rules*, as well as related amendments to the various other Acts. Draft amendments to the *Income Tax Regulations*, with corresponding explanatory notes, are also included.

These explanatory notes describe these amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

The Honourable Paul Martin
Minister of Finance

These explanatory notes are provided to assist in an understanding of amendments to the *Income Tax Act*, the *Income Tax Application Rules* and various other Acts. 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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Clause 2

Income Inclusions

ITA
12

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

Subclause 2(1)

ITA
12(1)(*e*.1)

New paragraph 12(1)(*e*.1) of the Act requires an insurer to include in computing its income for a taxation year a prescribed amount for "negative reserves" arising in respect of its insurance policies other than life insurance policies. Section 1400 of the *Income Tax Regulations* prescribes the amount of negative policy reserves that must be included in income under new paragraph 12(1)(*e*.1). New subsection 20(22) of the Act provides the insurer with a deduction from income for the amount of negative policy reserves included in income in the preceding taxation year. In general terms, negative policy reserves arise where the present value of future premiums exceeds the present value of future estimated benefits and expenses in respect of the insurer's policies.

New paragraph 12(1)(*e*.1) applies to the 1996 and subsequent taxation years.

Subclause 2(2)

ITA
12(1)(*o*)

Paragraph 12(1)(*o*) of the Act generally requires that a taxpayer include in income for a taxation year amounts that become receivable in the year as a royalty or similar amount reserved by the Crown in

relation to the production in Canada of petroleum, natural gas, metals or minerals extracted from property in Canada in respect of which the taxpayer has an interest.

Paragraph 12(1)(*o*) is amended to provide that amounts receivable by the Crown in respect of the late receipt or non-receipt of royalties or similar amounts are likewise included in computing a taxpayer's income. Such amounts would include interest and penalties in respect of Crown royalties.

Paragraph 12(1)(*o*) is also amended so that it applies in respect of sulphur royalties. This amendment relates to the inclusion of "Canadian field processing" as an activity that generates the resource allowance. "Canadian field processing" would include processing that results in the creation of sulphur from raw natural gas. For more detail in this regard, see the commentary on the new definition of "Canadian field processing" in subsection 248(1).

This amendment applies to taxation years that begin after 1996.

Subclause 2(3)

ITA
12(1)(*z*.5)

New paragraph 12(1)(*z*.5) of the Act is introduced so that 25% of a taxpayer's prescribed resource loss for a taxation year is included in computing the taxpayer's income for the year. This measure is designed to provide for symmetrical treatment of profits and losses from resource activities.

It is proposed to prescribe a taxpayer's resource loss for this purpose under section 1210.1 of the *Income Tax Regulations*. A taxpayer will generally have a prescribed resource loss for this purpose only to the extent that the taxpayer's adjusted resource profits, as determined under subsection 1210(2) of the Regulations, are a negative amount. However, a taxpayer's "Canadian exploration and development overhead expense" (as defined in subsection 1206(1) of the Regulations) that is incurred in a taxation year will also be added in computing the taxpayer's prescribed resource loss for the year. For further detail, see Appendix A to these explanatory notes.

This amendment applies to taxation years that begin after 1996.

Clause 3

Recaptured Depreciation

ITA
13

Section 13 of the Act provides a number of rules relating to the tax treatment of depreciable property. They generally apply for the purposes of sections 13 and 20 and the capital cost allowance regulations.

Subclause 3(1)

ITA
13(5)

Subsection 13(5) of the Act contains the rules for computing the undepreciated capital cost (UCC) of depreciable property that has been transferred from one prescribed class (the former class) to another. Under paragraph 13(5)(*a*), the capital cost of transferred property is effectively transferred from the former class to the other class. Under paragraph 13(5)(*b*), the total depreciation taken in respect of the former class is reduced, and the total depreciation considered to have been taken in respect of the other class is increased, by an identical amount. This amount is generally based on the capital cost allowance in respect of the former class attributed, for the purposes of the subsection, to the transferred property. However, subparagraph 13(5)(*b*)(i) ensures that the adjustment to total depreciation under paragraph 13(5)(*b*) cannot result in recapture under subsection 13(1) in respect of the former class in the event that a single property is transferred. Subparagraph 13(5)(*b*)(i) achieves this result by providing that the minimum adjustment to the total depreciation of the two classes is equal to the amount by which the capital cost of the transferred property exceeds the UCC of the former class, immediately before the transfer.

Subsection 13(5) is amended to clarify that it applies as a consequence of the change to the Income Tax Act or Regulations. For

example, if "manufacturing and processing" property included in Class 29, 39 or 43 of Schedule II to the Regulations becomes included in another class of Schedule II, subsection 13(5) would apply. In this context, it is proposed to amend Class 41 of Schedule II so that such property acquired in connection with "Canadian field processing" will now be included in Class 41 of Schedule II as of the beginning of a taxpayer's first taxation year that begins after 1996. For further detail, see Appendix A to these explanatory notes.

Subsection 13(5) is also amended to take into account the simultaneous change in status of more than one of a taxpayer's properties of a prescribed class. The objective of this amendment is to prevent recapture from being realized in respect of a former class of depreciable property as a consequence of the simultaneous change in status of more than one depreciable property included in that class. Further detail in this regard is provided in the example below.

Subsection 13(5) is also amended to take into account the fact that a change in status of property may occur at the beginning of a taxpayer's taxation year, which implies that the existing reference to UCC determined immediately before the change in status is not appropriate because such amount would not take into account depreciation claimed for the taxation year immediately preceding the change of status. To properly take in account such changes in status, new subsection 13(5) applies immediately after a change in status.

The amendments to subsection 13(5) are illustrated in the following example:

EXAMPLE

> *Gasco has two assets in Class 43 at the end of its 1996 taxation year (December 31, 1996). Asset A's capital cost was $10,000. Asset B's capital cost was $30,000. These assets become included in Class 41 at the beginning of Gasco's 1997 taxation year (January 1, 1997). The UCC of Class 43 at the end of 1996 is $1,000, as a consequence of the disposition in 1996 of an asset that was previously included in Class 43. No deductions under paragraph 20(1)(a) in respect of Class 43 were claimed for the 1995 taxation year, in which the two assets were acquired, or for the 1996 taxation year.*

Results:

1. The UCC of Class 43 on January 1, 1997 is nil. This is calculated as follows:

Add $ 1,000.....UCC at end of 1996

Minus 10,000.....Asset A capital cost, as per s.13(5)(a)

Minus 30,000.....Asset B capital cost, as per s.13(5)(a)

Add 39,000.....The greater of:

- *($40,000 - $1,000)*
  = $39,000 (as per s.13(5)(b)(i)), and

- *nil (as per s.13(5)(b)(ii)).*

2. The UCC of Class 41 on January 1, 1997 is $1,000. This is calculated as follows:

Add $10,000.....Asset A capital cost, as per s.13(5)(a)

Add 30,000.....Asset B capital cost, as per s.13(5)(a)

Minus 39,000....As per s.13(5)(b).

These amendments apply to changes of status that occur after 1996.

Subclause 3(2)

ITA
13(7.5)

New subsection 13(7.5) of the Act provides rules allowing certain payments and costs to be treated as the capital cost of depreciable property for the purposes of the Act.

Paragraph 13(7.5)(*a*) applies if a taxpayer is required under the terms of a contract that is made after March 6, 1996 to make a payment to Her Majesty in right of Canada or a province or to a Canadian municipality in respect of certain townsite costs incurred by the

recipient to acquire a property as prescribed in the *Income Tax Regulations*. Where this is the case, the taxpayer is considered to have acquired the property at a capital cost equal to the portion of the payment in respect of those costs. The time of acquisition of the property by the taxpayer is considered to be the later of the time the payment is made and the time at which those costs are incurred. Paragraph 13(7.5)(*a*) replaces existing subsection 1102(18) of the Regulations. It is proposed that property relating to townsites be prescribed, for the purpose of paragraph 13(7.5)(*a*), in proposed subsection 1102(14.2) of the Regulations. For further detail, see Appendix A to these explanatory notes.

Paragraph 13(7.5)(*b*) applies where, at any time after March 6, 1996, a taxpayer incurs a cost on account of capital for the building of, for the right to use or in respect of a prescribed property and the amount of the cost would otherwise not be included in the capital cost to the taxpayer of a depreciable property. Where this is the case, the taxpayer is deemed to have acquired the property at a capital cost equal to the amount of the cost incurred. It is proposed that property relating to roads and similar projects be prescribed for this purpose in proposed subsection 1102(14.3) of the Regulations. For further detail, see Appendix A to these explanatory notes.

If a taxpayer acquires an intangible property as a consequence of making a payment or incurring a cost described above, paragraph 13(7.5)(*c*) provides that the intangible property is to be treated as part of the depreciable property that is deemed to be acquired. The capital cost of a particular intangible property is equal to a proration factor multiplied by the lesser of the deemed capital cost of the depreciable property and the fair market value of all intangible properties so acquired. The proration factor for a particular intangible property is its fair market value divided by the fair market value of all the intangible properties so acquired. The operation of paragraph 13(7.5)(*c*) is illustrated by the following example:

EXAMPLE

> *In order to be able to establish a factory at a particular location, a taxpayer builds a road to the factory at a cost of $10 million. The road is owned by the municipality in which the factory is located, but the municipality provides the taxpayer with exclusive access to two parts of the road indefinitely. The fair market values of these access rights are $200,000 and $300,000.*
>
> *Results:*
>
> *1. The taxpayer is deemed to acquire a road (Class 17 property) for $10 million.*
>
> *2. The access rights are considered to be part of the road. The capital costs of these rights are, because of paragraph 13(7.5)(c), considered to be $200,000 and $300,000, respectively.*

Paragraph 13(7.5)(*d*) provides that any property deemed by the above rules to have been acquired at any time by the taxpayer as a consequence of making a payment or incurring a cost

- is deemed to have been acquired for the purpose for which the payment was made or the cost was incurred, and
- is deemed to be owned by the taxpayer at any subsequent time that the taxpayer benefits from the use of the property.

These amendments should be read in conjunction with proposed amendments to:

- the definitions "foreign exploration and development expenses", "Canadian exploration expense" and "Canadian development expense" in sections 66 to 66.2 of the Act,
- paragraph 1102(1)(*a*) and subsections 1102(14.2), (14.3) and (18) of the Regulations, and
- Classes 8 and 17 of Schedule II to the Regulations.

The purpose of these amendments is to prevent costs associated with the building of roads and similar projects from being considered as

eligible capital expenditures while, at the same time, ensuring that classification of such costs as Canadian exploration expenses, Canadian development expenses and foreign exploration and development expenses is restricted to the building of temporary access roads. The resulting capital cost allowance claimed by a taxpayer in respect of such costs can result in a reduction of the taxpayer's resource allowance under section 1210 of the Regulations.

These amendments apply to taxation years that end after March 6, 1996.

Clause 4

Disallowed Deductions

ITA
18

Section 18 of the Act prohibits the deduction of certain outlays and expenses in computing a taxpayer's income from a business or property.

Subclause 4(1)

ITA
18(1)(*m*)

Paragraph 18(1)(*m*) of the Act prevents a taxpayer from deducting amounts in computing income that are paid or payable in the year as Crown royalties or similar amounts in relation to the production in Canada of petroleum, natural gas, metals or minerals.

Paragraph 18(1)(*m*) is amended to provide that amounts payable to the Crown in respect of the late payment or non-payment of royalties or similar amounts are likewise not deductible in computing a taxpayer's income. Such amounts would include interest and penalties in respect of Crown royalties.

Paragraph 18(1)(*m*) is amended so that it applies in respect of sulphur royalties. This amendment relates to the inclusion of "Canadian field processing" as an activity that generates the resource allowance.

"Canadian field processing" would include processing that results in the creation of sulphur from raw natural gas. For more detail in this regard, see the commentary on the new definition of "Canadian field processing" in subsection 248(1) of the Act.

This amendment applies to taxation years that begin after 1996.

Subclause 4(2)

ITA
18(1)(*t*)

Paragraph 18(1)(*t*) of the Act provides that no amount paid or payable under the Act is deductible in computing a taxpayer's income.

Paragraph 18(1)(*t*) is amended so that it does not apply to tax paid or payable under new Part XII.6 of the Act.

Paragraph 18(1)(*t*) is also amended to clarify that the deduction provided under subsection 104(30) of the Act for Part XII.2 tax is available to a trust.

These amendments apply to the 1997 and subsequent taxation years.

ITA
18(1)(*u*)

New paragraph 18(1)(*u*) of the Act provides that no amount is deductible by a taxpayer on account of payments made for services in respect of a retirement savings plan (RSP) or retirement income fund (RIF), if the taxpayer is the annuitant under the RSP or RIF. As a result, administration fees paid by the annuitant of a registered retirement savings plan or a registered retirement income fund will no longer be deductible. This provision also confirms that investment counselling fees paid in respect of RSP or RIF property will continue to be non-deductible.

This amendment applies to amounts paid or payable after March 5, 1996.

Subclause 4(3)

ITA
18(5)

"outstanding debts to specified non-residents"

Subsection 18(5) of the Act defines certain expressions for the purposes of the "thin capitalization" rules in subsections 18(4) to (8) of the Act. The thin capitalization rules disallow the deduction by a corporation of interest on debts owing to certain non-residents to the extent that the corporation's debt to equity ratio in relation to the non-residents exceeds 3 to 1. The debts included in that ratio are defined under subsection 18(5) as the "outstanding debts to specified non-residents". A debt owing to a non-resident insurer is excluded from this definition if the debt is "property used by it in the year in, or held by it in the year in the course of" (as defined in subsection 138(12) of the Act) carrying on an insurance business through a permanent establishment in Canada. In general terms, "property used by it in the year in, or held by it in the year in the course of" carrying on an insurance business is property which is considered to support the insurer's Canadian insurance business and is determined in accordance with rules in Part XXIV of the *Income Tax Regulations*.

The definition of "property used by it in the year in, or held by it in the year in the course of" carrying on an insurance business in subsection 138(12) is replaced by the definition of "designated insurance property". Consequential upon that amendment, paragraph (*b*) of the definition of "outstanding debts to specified non-residents" is amended so that it refers to the new definition of "designated insurance property". Paragraph (*b*) is also amended to clarify that permanent establishment has the meaning assigned by the Regulations.

This amendment applies to the 1996 and subsequent taxation years.

Clause 5

Income from a Business or Property – 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 a business or property.

Subclause 5(1)

ITA
20(1)(*mm*)

Paragraph 20(1)(*mm*) of the Act allows a taxpayer to deduct, in computing income for a taxation year, certain costs of substances injected into a natural reservoir to assist in the recovery of petroleum, natural gas or related hydrocarbons, provided that such costs were incurred in the year or a previous year.

Existing subparagraphs 20(1)(*mm*)(iii) and (iv) clarify that these costs do not include Canadian exploration expenses (CEE), Canadian development expenses (CDE) or Canadian oil and gas property expenses (COGPE). These subparagraphs are being repealed, since CEE, CDE and COGPE definitions are not broad enough to include these costs.

These amendments apply to the 1996 and subsequent taxation years.

ITA
20(1)(*nn*)

New paragraph 20(1)(*nn*) of the Act provides that tax paid or payable by a taxpayer under new Part XII.6 of the Act for a taxation year is deductible in computing the taxpayer's income for the year. Unless the taxpayer is entitled to report income using cash basis accounting, the deduction is provided in computing income for the year in which the Part XII.6 tax becomes payable.

This amendment applies to the 1997 and subsequent taxation years.

Subclause 5(2)

ITA
20(7)(*c*)

Paragraph 20(7)(*c*) of the Act provides that an insurer may deduct a prescribed amount as a policy reserve in respect of its insurance businesses other than life insurance businesses. Section 1400 of the *Income Tax Regulations* prescribes the amount that may be deducted under paragraph 20(7)(*c*). The amendments to this paragraph are strictly consequential on the amendments to section 1400 of the Regulations and ensure that the wording of these provisions corresponds.

Amended paragraph 20(7)(*c*) applies for the 1996 and subsequent taxation years.

Subclause 5(3)

ITA
20(22)

New subsection 20(22) of the Act provides that an insurer may deduct, in computing its income from an insurance business other than a life insurance business, any amount included in income in the preceding year as a negative policy reserve pursuant to new paragraph 12(1)(*e*.1) of the Act. In general terms, negative policy reserves arise where the present value of future premiums exceeds the present value of future estimated benefits and expenses in respect of the insurer's policies.

New subsection 20(22) applies to the 1996 and subsequent taxation years.

Clause 6

Scientific Research and Experimental Development

ITA
37

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

ITA
37(9.1)

New subsection 37(9.1) limits the amount that a taxpayer may claim as an SR&ED expense for a year in respect of salary and wages of a specified employee of the taxpayer to five times the Year's Maximum Pensionable Earnings (YMPE) as determined under section 18 of the *Canada Pension Plan*. The expression "specified employee" is defined in subsection 248(1) of the Act. The YMPE for 1996 is $35,400. This maximum amount is prorated for short taxation years.

ITA
37(9.2) to (9.5)

New subsections 37(9.2) to (9.5) of the Act provide rules for determining the allocation of salary and wages of an individual who is a specified employee of two or more associated corporations.

New subsection 37(9.2) provides that no amount may be included as SR&ED expenditures in respect of that individual's salary and wages under clauses 37(8)(*a*)(ii)(A) or (B) unless all of the associated corporations file an agreement described in new subsection 37(9.3).

New subsection 37(9.3) provides a mechanism for the allocation of the amount described in new subsection 37(9.1) among associated corporations by filing an agreement with Revenue Canada.

New subsection 37(9.4) sets out the following filing requirements for agreements referred to in new subsection 37(9.3): first, the agreement must be in prescribed form and second, where the taxpayer is a

corporation, the agreement must be accompanied by either the directors' resolution or a certified copy of the other document which authorized the agreement.

New subsection (9.5) applies for the purposes of new subsections (9.2), (9.3) and (9.5) to deem an individual who is related to a particular corporation, and certain partnerships with members related to or associated with a particular corporation, to be corporations associated with the particular corporation.

New subsections 37 (9.1) to (9.5) apply to taxation years that begin after March 5, 1996.

Clause 7

Adjustments to Cost Base

ITA
53

Section 53 of the Act sets out rules for determining the adjusted cost base of capital property for the purposes of calculating any capital gain or loss on its disposition.

Subclause 7(1)

ITA
53(1)(*e*)(i)(B)

Subparagraph 53(1)(*e*)(i) of the Act applies for the purposes of computing the adjusted cost base (ACB) of a partner's interest in a partnership. In computing the partner's ACB of the interest, there is added the partner's share of partnership income computed without reference to a number of specified provisions in the Act.

Clause 53(1)(*e*)(i)(B) is amended to ensure that new paragraph 12(1)(*z*.5) of the Act is ignored for this purpose. This is appropriate because, pursuant to amended paragraph 96(1)(*d*) of the Act, paragraph 12(1)(*z*.5) is ignored for the purpose of allocating income at the partnership level to partners.

This amendment applies for the purposes of computing the ACB of a partnership interest after 1996.

Subclause 7(2)

ITA
53(2)(*c*)(i)(B)

Subparagraph 53(2)(*c*)(i) of the Act applies for the purposes of computing the ACB of a partner's interest in a partnership. In computing the partner's ACB of the interest, there is subtracted the partner's share of partnership losses computed without reference to a number of specified provisions in the Act.

Clause 53(2)(*c*)(i)(B) is amended to ensure that new paragraph 12(1)(*z*.5) of the Act is ignored for this purpose. This is appropriate because, pursuant to amended paragraph 96(1)(*d*) of the Act, paragraph 12(1)(*z*.5) is ignored for the purpose of allocating losses at the partnership level to partners. A corresponding amendment is being made to subsection 26(9.4) of the *Income Tax Application Rules*.

This amendment applies for the purposes of computing the ACB of a partnership interest after 1996.

Clause 8

Amounts Included in Income

ITA
56

Section 56 of the Act lists certain types of income that are required to be included in computing the income of a taxpayer from sources other than property, business and employment.

Subclause 8(1)

ITA
56

The provisions governing the inclusion in income for tax purposes of support payments are contained in paragraphs 56(1)(*b*), (*c*), and (*c*.2), and subsections 56(12) and 56.1(1), (2) and (3) of the Act. Parallel provisions dealing with the deductibility of support payments by a payer are found in paragraphs 60(*b*), (*c*) and (*c*.2) and subsections 60.1(1), (2) and (3) of the Act. In order to implement changes to the tax treatment of child support payments, many of these provisions are being substantially revised.

Overview

Under the new regime for child support payments, payments received under orders or agreements will not be included in the income of the recipient nor deductible from the income of the payer if a number of conditions are met. These conditions, which relate to the nature of the payment, the agreement or order under which it is made, and the relation the payment bears to any other support payments that are required to be made, are outlined below.

Nature of the payment

The new treatment of child support payments will not apply to payments that are made for the support of a spouse or former spouse. Because spousal support will continue to be included in the income of the recipient and deductible from the income of the payer, it is necessary that child support amounts be distinguished from any other support amounts that may be required to be paid.

The distinction between amounts that are in respect of child support and other support amounts is contained in the definitions "support amount" and "child support amount" in new subsection 56.1(4) of the Act. The definition "support amount", which incorporates the existing provisions of paragraphs 56(1)(*b*) and (*c*) and subsection 56(12) of the Act, requires amounts to be

- allowances on a periodic basis;

- for the maintenance of the recipient or children;
- at the discretionary use of the recipient;
- paid to a spouse or former spouse who is living separate and apart from the payer because of a breakdown or their marriage or paid in respect of a natural child of the payer; and
- paid under an order of a competent tribunal or a written agreement.

A "child support amount" is defined as a support amount that is not identified as being solely for the support of a spouse or former spouse or the parent of the payer's child. Therefore, for example, if a written agreement provides for a global amount of support to be paid in respect of a spouse and child, the amount will be considered, for purposes of the income tax rules, to be a child support amount. This same treatment will apply to amounts that are required to be paid directly to third parties and that are, because of the provisions of subsection 56.1(2) of the Act, considered to be support amounts. Such third-party payments will be treated as child support amounts unless the agreement or order under which they are made clearly identifies the payments as being solely for the support of a spouse, former spouse or parent of the payer's child.

Agreement or order

The new tax treatment of child support payments will apply to payments required to be made under agreements or orders made after April 1997. It will also apply to agreements or orders that predate May 1997 in certain circumstances. These circumstances are provided in the definition "commencement day" in new subsection 56.1(4) of the Act.

The definition "commencement day" provides that an agreement or order will have a date fixed as its commencement day if certain conditions are met. The commencement day of a agreement or order is used in the formula contained in revised paragraphs 56(1)(*b*) and 60(*b*) of the Act to determine whether payments are to be included in the income of the recipient and deductible by the payer. In general, support payments made in a year will be included in the income of the recipient and deductible from the income of the payer only to the

extent that they exceed all child support payments that are required to be made to the recipient by the payer under agreements or orders on or after their commencement days.

As provided in the definition "commencement day", the commencement day of an agreement or order made after April 1997 will be the day on which it is made. An agreement or order that predates May 1997 will only have a commencement day if certain conditions are met. The commencement day for an agreement or order that predates May 1997 is determined in a number of ways.

- The payer and recipient may file a joint election with the Minister of National Revenue, in prescribed form and manner, in which they specify a day as the commencement day for the agreement or order.

- If the amount of child support payable under an agreement or order is varied after April 1997, the agreement or order will have as its commencement day the day on which the first payment of the varied amount is required to be made.

- If another agreement or order is made after April 1997 and the effect of that subsequent agreement or order is to change the total child support amounts payable to the recipient by the payer, the commencement day of the original agreement or order will be the day of the first subsequent agreement or order.

- Finally, for purposes of these rules, a commencement day may be specified in an agreement, order or variation.

It should be noted that the commencement day of an agreement or order cannot be a day that is before May 1997.

As a result of these provisions, an order or agreement that predates May 1997 and to which none of the above-noted conditions apply will not have a commencement day. Therefore, when the formulae in revised paragraphs 56(1)(*b*) and 60(*b*) are applied to payments made under such an agreement or order, the result will be that amounts continue to be included in the income of the recipient and deductible from the income of the payer. On the other hand, if an agreement or order is made after April 1997 and provides only for child support

payments, payments made under that agreement or order will not be included in the income of the recipient and will not be deductible from the income of the payer.

Relation of child support to other support payments

Because the new rules for child support payments apply only to payments made on or after the commencement day of an agreement or order and also do not apply to amounts that are not in respect of child support, situations may arise where, in the absence of specific rules, the tax treatment of a particular payment cannot readily be determined. This will occur, for example, where payments made during a year under an agreement or order made after April 1997 that provides for both child and spousal support fall short of the total required to be paid. Another example of the need to identify payments for tax purposes will occur where an agreement or order is varied after April 1997 and support payments are in arrears at the time. Where a payment is made, its tax treatment would depend on whether it is to be considered to be a payment in respect of a child support obligation arising after the date of the agreement, order or variation (and therefore not to be included in the recipient's income nor deductible by the payer) or whether it represents the payment of spousal support or child support arrears (and is therefore to be included in the recipient's income and deductible by the payer).

The formulae in revised paragraphs 56(1)(*b*) and 60(*b*), which determine the amount to be included in the income of the recipient and deductible by the payer, provide a basis to deal with these situations. In general, the formulae provide that, in any year, the amount included or deductible will only be based on support amounts paid to the extent that these amounts exceed all child support amounts that became receivable or payable on or after the commencement day of the order or agreement under which they are required to be made. The effect of these provisions is that there will be no income inclusion or deduction where the amount of support that has been paid falls short of the amount of child support that is required under agreements or orders on or after their commencement days. In essence, this may be regarded as an "ordering" rule. Payments are first considered to be in respect of child support obligations the payments of which are not intended to give rise to income inclusions or deductions because they have arisen under

agreements or orders that have either been made after April 30, 1997 or in respect of which a commencement day has otherwise been established.

ITA
56(1)(*b*) and (*c*)

Paragraph 56(1)(*b*) of the Act requires the inclusion in income of periodic maintenance payments received by a separated or divorced spouse pursuant to a decree, order or judgment of a competent tribunal or under a written order. Paragraph 56(1)(*c*) requires the inclusion in income of periodic maintenance payments received pursuant to an order of a competent tribunal made in accordance with the laws of a province where the recipient is living separate and apart from the payer and the payer is the natural parent of a child of the recipient. These two provisions are paralleled by paragraphs 60(*b*) and (*c*) of the Act, which provide that the payer of such amounts may deduct them from income under the same conditions.

Paragraphs 56(1)(*b*) and (*c*) are replaced by revised paragraph 56(1)(*b*). As noted in the overview, revised paragraph 56(1)(*b*) contains a formula to determine the amount to be included in the income of a recipient in respect of support amounts (as defined in new subsection 56.1(4)) received. Revised paragraph 56(1)(*b*) applies to amounts received after 1996.

The description of A in the formula represents the total of all support amounts received after 1996 and before the end of the year while the payer and recipient were living separate and apart. The total of all child support amounts receivable under agreements or orders after their commencement days (as defined in new subsection 56.1(4)) and before the end of the year in respect of periods that began after those commencement days is represented by the variable B, and is deducted from A. The description of C in the formula represents those amounts that have been included in the recipient's income for preceding years, and is also deducted from A. Thus, amounts to be included in the income of a recipient of support are determined by comparing all support amounts received after 1996 with the amount of all child support obligations that pertain to periods after commencement day and with support amounts that have been received and included in income for a preceding year. Only amounts that exceed the total of those child support obligations and prior year income inclusions are

included in current year income. The following example illustrates the application of this formula to an order that is made before May 1997 and varied after that time.

EXAMPLE

Jean and Sandy have a court order made on December 1, 1996 under which Jean is required to pay Sandy support of $400 per month for the maintenance of their child. On July 1, 1997 the order is varied to increase the monthly child support to $500, beginning as of that date. During 1997, Jean makes payments to Sandy under the order totalling $4000. The formula in revised paragraph 56(1)(b) (and the parallel formula in revised paragraph 60(b)), together with the definitions in new subsection 56.1(4) produce the following results for 1997:

- *The commencement day for Jean and Sandy's order is July 1, 1997 (the day on which the first increased child support amount is required to be made);*

- *the value of A in the formula in revised paragraph 56(1)(b) and 60 (b) is calculated as the total support amounts received after 1996 and before the end of 1997 = $4000*

- *the value of B in the formula is calculated as the total child support amounts that became receivable after commencement day and before the end of the year in respect of periods that began after commencement day*

  = $500/month x 6 months
  (July through December) = $3000

- *the value of C in the formula is calculated based on amounts received in 1997 and included in income in a preceding year*
  = $ 0

- *the resulting income inclusion and deduction*

  = A - (B + C) = $1000

Subclause 8(2)

ITA
56(1)(*d*.2)

Paragraph 56(1)(*d*.2) of the Act provides for the inclusion in income of any amount received from a specified annuity, or as proceeds of disposition of a specified annuity. An annuity is specified for this purpose where payment for the annuity was deductible under paragraph 60(*l*) or former subsection 146(5.5) of the Act (which dealt with the acquisition of annuities by individuals who had disposed of qualified farm property) or where the annuity was acquired with funds paid out of a prescribed provincial pension plan in accordance with subsection 146(21) of the Act.

Paragraph 56(1)(*d*.2) is amended to add as a specified annuity an annuity purchased for a beneficiary under a deferred profit sharing plan (DPSP). As a result of this amendment, DPSP annuity payments are not longer included in income by virtue of paragraph 56(1)(*d*). This amendment also ensures that there is an income inclusion on the disposition of a DPSP annuity. Therefore, it is relevant to new subsection 147(10.6) of the Act which, with some exceptions, deems the beneficiary of a DPSP annuity purchased before 1997 to have disposed of the annuity if it does not commence to be paid by the end of the year in which the beneficiary turns 69 years of age (see the commentary on new subsection 147(10.6) for further details).

This amendment applies to the 1996 and subsequent taxation years.

Subclause 8(3)

ITA
56(12)

The provisions in the Act that deal with the tax treatment of spousal support require that an amount paid and received be in the form of an allowance. Subsection 56(12) of the Act provides that, for these purposes, an "allowance" will not include any amount unless the recipient has discretion as to its use.

Subsection 56(12) is repealed, with application to amounts received after 1996. The subsection is no longer required because the condition

that a recipient must have discretion as to the use of an amount is now contained in the definition of "support amount" in new subsection 56.1(4) of the Act.

Clause 9

Maintenance

ITA
56.1

Section 56.1 of the Act treats certain support payments made to third parties for the benefit of an individual who is a spouse, former spouse or parent of a payer's child as having been received by the individual so that the payments are included in the individual's income. Parallel provisions that apply to permit a payer of such amounts to deduct them from income are found in subsection 60.1 of the Act.

Subclause 9(1)

ITA
56.1(1)

Subsection 56.1(1) of the Act provides that, where a court order or written agreement provides for the periodic payment of an amount to or for the benefit of a taxpayer who is the spouse, former spouse or parent of the payer's child, the amount, when paid, is to be considered to have been paid to and received by the taxpayer. Subsection 60.1(1) is a parallel provision that applies in respect of the deduction available to a payer.

Subsection 56.1(1) is revised as part of the implementation of the new rules for the tax treatment of child support. As revised, subsection 56.1(1) applies not only for the purpose of paragraph 56(1)(*b*), but also for the purpose of subsection 118(5) of the Act, under which an individual who is required to make support payments in respect of a person is not also entitled to claim personal tax credits for that person. As well, subsection 56.1(1) is expanded to deem amounts that are payable to third parties in respect of a taxpayer to be payable to and receivable by the taxpayer. This amendment ensures that any such amounts that are payable in respect

of child support will be taken into consideration in determining the amount of the income inclusion for support in revised paragraph 56(1)(*b*) of the Act. Similar amendments are being made to subsection 60.1(1) of the Act, so that such amounts will also be taken into consideration in determining the corresponding deduction available to a payer.

These amendments apply to amounts received after 1996.

Subclauses 9(2), (3) and (4)

ITA
56.1(2)

Subsection 56.1(2) of the Act provides that certain third-party payments made pursuant to a written agreement or court order in respect of an expense such as a medical bill, mortgage payment or payment of tuition fees are to be considered to be paid to and received by a taxpayer as an allowance on a periodic basis if certain conditions are met. Subsection 60.1(2) of the Act is a parallel provision that applies for purposes of the rules on the deductibility of support. Both subsections are revised as part of the implementation of the new rules for the tax treatment of child support.

First, the references in the subsection are changed so that subsection 56.1(2) applies not only for the purpose of paragraph 56(1)(*b*), but also for the purpose of subsection 118(5) of the Act, under which an individual who is required to make support payments in respect of a person is not also entitled to claim personal tax credits for that person.

Second, the description of A in the formula in the subsection is revised so that it refers to the definition of support amount in new subsection 56.1(4). The description is also changed to refer to amounts that became payable, rather than amounts paid. This change ensures that any such amounts that are considered payable as child support will be taken into consideration in determining the amount of the income inclusion for support in revised paragraph 56(1)(*b*) of the Act.

Third, the postamble to the subsection is revised to include references to amounts that are payable as well as those that are paid. As well, in

order to ensure that these third-party amounts will not fail to be considered to be support amounts because the recipient does not have discretion as to their use, the revised postamble deems the recipient to have such discretion.

Theses amendments apply to amounts received after 1996.

Subclause 9(5)

ITA
56.1(3)

In order to be included in the income of a recipient and deductible by a payer, support payments must be made pursuant to a written agreement or court order. Subsection 56.1(3) of the Act provides an exception to this requirement where a court order or written agreement is made before the end of the following year and provides that amounts received are to be considered to have been paid and received under the agreement or order. Subsection 60.1(3) of the Act is a parallel provision that applies to the rules on the deductibility of payments.

Subsection 56.1(3) is revised, applicable to amounts received after 1996, as part of the implementation of the new rules for the tax treatment of child support.

Revised subsection 56.1(3) not only deems amounts to be received under an written agreement or order when it so provides, but also deems the agreement or order to be made on the day on which the first amount was received. This change is necessary for purposes of determining the commencement day of such an agreement or order, which will, in turn, determine the treatment of support payments under the formulae in paragraphs 56(1)(*b*) and 60(*b*). The following example illustrates this interaction.

EXAMPLE

> *Adrian and Carey separate on January 1, 1997. Beginning on that date, Adrian pays Carey $400 per month for the support of their child. On July 1, 1997, the couple enter into a written separation agreement that provides that the amounts received before that time and in the year are to be considered to have been paid and received under the agreement.*
>
> *Under the provisions of subsection 56.1(3), Adrian and Carey's agreement will be deemed to have been made on the day the first payment was received: January 1, 1997. Because of this, when the definition "commencement day" is applied, the agreement will not have a commencement day. As a result, when the formulae in revised paragraphs 56(1)(b) and 60(b) are applied, all payments made under the agreement will be included in Carey's income and will be deductible from income by Adrian.*

Subclause 9(6)

ITA
56.1(4)

"child support amount"
"commencement day"
"support amount"

New subsection 56.1(4) of the Act contains three definitions that apply for purposes of sections 56 and 56.1.

"child support amount"

A "child support amount" is defined as any support amount that is not identified as being solely for the support of a spouse, former spouse or parent of the payer's child. An explanation of this definition and its application can be found in the overview in subclause 8(1) of these notes.

"commencement day"

The definition "commencement day" provides that an agreement or order will have a date fixed as its commencement day if certain

conditions are met. An explanation of this definition and its application can be found in the overview in subclause 8(1) of these notes.

"support amount"

The definition "support amount" provides the an amount will be considered to be a "support amount" if certain conditions are met. An explanation of this definition and its application can be found in the overview in subclause 8(1) of these notes.

These definitions apply after 1996.

Clause 10

Other deductions

Section 60 of the Act provides a number of deductions in computing income, many of which relate to certain income inclusions required under section 56 of the Act.

ITA
60(*b*)

Paragraphs 60(*b*) and (*c*) of the Act deal with deductions in respect of support payments, and are parallel to the provisions of paragraphs 56(1)(*b*) and (*c*) of the Act which deal with the corresponding income inclusions. As part of the implementation of the new rules for child support payments, paragraphs 60(*b*) and (*c*) are replaced with revised paragraph 60(*b*). As revised, paragraph 60(*b*) parallels revised paragraph 56(1)(*b*), providing a deduction to a payer of support payments that mirrors the income inclusion required by a recipient under that paragraph. For an explanation of these new rules, reference should therefore be made to the overview in subclause 8(1) of these notes, as well as the comments on revised paragraph 56(1)(*b*).

Clause 11

Maintenance Payments

ITA
60.1

Section 60.1 of the Act treats certain support payments made to third parties for the benefit of a person who is a spouse, former spouse or parent of a payer's child as having been received by that person so that the payments are deductible from the income of the payer. Parallel provisions that apply to require a recipient of such amounts to include them in income are found in subsection 56.1 of the Act.

Subclause 11(1)

ITA
60.1(1)

Subsection 60.1(1) of the Act provides that, where a court order or written agreement provides for the periodic payment of an amount to or for the benefit of a person who is the spouse, former spouse or parent of the payer's child, the amount, when paid, is to be considered to have been paid to and received by that person. Subsection 56.1(1) of the Act is a parallel provision that applies in respect of the income inclusion rules for recipients of support.

The amendments to subsection 60.1(1) mirror those amendments made to subsection 56.1(1) in subclause 9(1) of this bill. Reference should therefore be made to the comments on revised paragraph 56.1(1) in these notes.

Subclauses 11(2), (3) and (4)

ITA
60.1(2)

Subsection 60.1(2) of the Act provides that certain third-party payments made pursuant to a written agreement or court order in respect of an expense such as a medical bill, mortgage payment or payment of tuition fees are to be considered to be paid to and received by a person as an allowance on a periodic basis if certain

conditions are met. Subsection 56.1(2) of the Act is a parallel provision that applies for purposes of the rules on the income inclusion of support.

The amendments to subsection 60.1(2) mirror those amendments made to subsection 56.1(2) in subclauses 9(2), (3) and (4) of this bill. Reference should therefore be made to the comments on revised paragraph 56.1(2) in these notes.

Subclause 11(5)

ITA
60.1(3)

In order to be included in the income of a recipient and deductible by a payer, support payments must be made pursuant to a written agreement or court order. Subsection 60.1(3) of the Act provides an exception to this requirement where a court order or written agreement is made before the end of the following year and provides that amounts received are to be considered to have been paid and received under the agreement or order. Subsection 56.1(3) of the Act is a parallel provision that applies to the rules on the income inclusion of such amounts.

The amendments to subsection 60.1(3) mirror those amendments made to subsection 56.1(3) in subclause 9(5) of this bill. Reference should therefore be made to the comments on revised paragraph 56.1(3) in these notes.

Subclause 11(6)

ITA
60.1(4)

New subsection 60.1(4) is added to the Act to provide that the definitions "child support amount", commencement day" and "support amount" in new subsection 56.1(4) also apply for the rules governing the deductibility of support payments in sections 60 and 60.1. New subsection 60.1(4) applies after 1996.

Clause 12

Child Care Expenses

ITA
63

Section 63 of the Act provides rules concerning the deductibility of chid care expenses.

Subclause 12(1)

ITA
63(1)

Subsection 63(1) of the Act enables a taxpayer to deduct, in computing income for tax purposes, qualifying child care expenses to the extent that they do not exceed certain amounts based on the taxpayer's income and number of eligible children. Paragraph 63(1)(*f*) provides that the amount that may be deducted by a taxpayer in respect of his or her eligible children is to be reduced by amounts deducted by any other individuals in respect of those children.

This amendment to paragraph 63(1)(*f*) is consequential to the addition of new subsection 63(2.2) to the Act. Under new subsection 63(2.2), an individual may deduct child care expenses in respect of periods during which the individual is in school. These deductions will reduce the amount that another taxpayer may claim under subsection 63(1). As a result, the wording of paragraph 63(1)(*f*), which refers to deductions under subsection 63(1), is modified to refer to amounts deducted under section 63.

This amendment applies to the 1996 and subsequent taxation years.

Subclause 12(2)

ITA
63(2)(*b*)

When more than one taxpayer contributes to the support of an eligible child, the child care expense deduction for the year must generally be claimed by the taxpayer with the lower income for the

year. However, in the circumstances specified in paragraph 63(2)(*b*) of the Act, the supporting person with the higher income may claim a deduction based on the number of weeks in the year throughout which the lower-income person is separated, infirm, confined to a bed or wheelchair, in prison or in full-time attendance at a designated educational institution.

This amendment to subparagraph 63(2)(*b*)(iii) expands the claim for child care expenses available to a higher-income taxpayer to include periods during which the lower-income person is in attendance at a secondary school. It also replaces the requirement that the lower-income person be in full-time attendance at the designated educational institution with a requirement that the lower-income person be enroled in a program of the institution or school of not less than 3 consecutive weeks duration that provides that each student in the program spend not less than 10 hours per week on courses or work in the program. These conditions are the same as those that apply for purposes of the new deduction in subsection 63(2.2).

These amendments apply to the 1996 and subsequent taxation years.

Subclause 12(3)

ITA
63(2.2) and (2.3)

New subsections 63(2.2) and (2.3) are added to the Act to provide a deduction for child care expenses in respect of periods during which a taxpayer is a student and is either the sole supporting person of an eligible child or, if there is another supporting person, is the supporting person with the higher income.

New subsection 63(2.2) provides that an amount (which is calculated under new subsection 63(2.3)) may be deducted where a taxpayer is a student at a designated educational institution or a secondary school and is enroled in a program of the institution or school of not less than 3 consecutive weeks duration that provides that each student in the program spend not less than 10 hours per week on courses or work in the program. As well, in order to be eligible for the deduction, the taxpayer must be the sole supporting person of an

eligible child or must be the supporting person with the higher income. The deduction must be made on a prescribed form filed with the taxpayer's return.

New subsection 63(2.3) contains the calculation of the deduction. The deduction is calculated as the least of:

(1) the amount paid for child care expenses incurred for services rendered in the year in respect of eligible children minus the amount deductible under subsection 63(1);

(2) 2/3 of the taxpayer's income (computed without reference to this section 63 and to paragraphs 60(*v*.1) and (*w*)) for the year;

(3) for each week that the taxpayer is a student (as provided in subsection 63(2.2)) and is the sole supporting person of an eligible child or, where there is another supporting person, that other person is also a student:

- $150 for each eligible child under age 7 or in respect of whom a disability tax credit is available, plus

- $90 for each additional eligible child;

(4) the amount by which the total calculated under subparagraph 63(1)(*e*)(ii) exceeds the amount deductible under subsection 63(1); and

(5) where there is another supporting person, the amount by which the amount calculated under paragraph 63(2)(*b*) exceeds 2/3 of the taxpayer's earned income.

New subsection 63(2.2) and (2.3) apply to the 1996 and subsequent taxation years.

Subclause 12(4)

ITA
63(3)

Subsection 63(3) of the Act contains the definition "child care expense". The definition provides that, among other things, expenses are only considered to be child care expenses if the services to which they relate are provided to enable a taxpayer to perform certain activities. These activities, which are listed in paragraph (*a*) of the definition, are: the performance of the duties of an office or employment, the carrying on of a business (either alone or as an active partner) and the carrying on of research or similar work if the taxpayer or supporting person receives a grant in respect of the activity.

Paragraph (*a*) of the definition "child care expense" is amended to add another activity to this list. The addition of new subparagraph (*a*)(v) ensures that expenses will also be considered to be child care expenses if the services to which they relate are provided to enable a taxpayer to attend a designated educational institution or a secondary school where the taxpayer is enroled in a program of the institution or school of not less than 3 consecutive weeks duration that provides that each student in the program spend not less than 10 hours per week on courses or work in the program.

This amendment applies to the 1996 and subsequent taxation years.

Subclause 12(5)

ITA
63(3)

Section 63(3) of the Act contains definitions for the purposes of the child care expense deduction.

The definition "eligible child" provides that a child must be under the age of 14 at any time during the year in order to be eligible for purposes of the child care expense deduction. This amendment raises the age from 14 to 16, so that a child care expense deduction will be available in respect of children up to and including the year in which they turn 16 years of age.

This amendment applies to the 1996 and subsequent taxation years.

Subclause 12(6)

ITA
63(3)

The definition "supporting person" in subsection 63(3) of the Act is necessary because of the general restriction of the deduction for child care expenses to the taxpayer with the lower income. A supporting person of an eligible child of a taxpayer includes only those persons listed who resided with the taxpayer at the same time during the year and at any time within 60 days after the end of the year.

This amendment to the definition "supporting person" simply clarifies that, for purposes of section 63, a supporting person is a person other than the taxpayer.

This amendment applies the 1983 and subsequent taxation years.

Clause 13

Exploration and Development Expenses

ITA
66

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

Subclause 13(1)

ITA
66(10) to (10.3)

Subsections 66(10) to (10.3) of the Act allow renunciations by joint exploration corporations (JECs) of Canadian exploration and development expenses, Canadian exploration expenses (CEE), Canadian development expenses (CDE) and Canadian oil and gas property expenses.

Subsections 66(10) to (10.3) are being repealed.

These amendments apply to renunciations made

- after 2006, in respect of a payment or loan received by a JEC before March 6, 1996,
- after 2006, in respect of a payment or loan received by a JEC after March 5, 1996 under an agreement in writing made before March 6, 1996 by the JEC (or by another corporation that either controlled the JEC or undertook, at the time the agreement was made, to form the JEC), and
- after March 5, 1996, in any other case.

Subclauses 13(2) to (4)

ITA
66(12.6)

Subsection 66(12.6) of the Act permits a principal-business corporation to renounce Canadian exploration expenses (CEE) to its flow-through shareholders. The CEE eligible for this treatment must generally be incurred in the 24-month period that begins on the day on which the relevant flow-through share agreement is entered into, and must be incurred on or before the effective date of the renunciation. (The effective date of a renunciation for an investor is a date specified by the flow-through corporation in the renunciation form. The investor is deemed to incur the renounced CEE on this date.)

Eligible CEE is reduced to reflect assistance in respect of such CEE and overhead expenses prescribed under Part XII of the *Income Tax Regulations*. Subsection 66(12.6) is amended to clarify that assistance in respect of CEE incurred after the effective date of a renunciation, as well as overhead expenses incurred after that date, do not reduce the CEE that can be flowed-through under the renunciation. This relieving amendment applies to expenses incurred after February 1996.

New paragraph 66(12.6)(*b*.1) is introduced so that an amount cannot be renounced under subsection 66(12.66) on the basis of a taxpayer's

costs of, or for the use of, "off-the-shelf" seismic data of the taxpayer. For this purpose, a taxpayer's "off-the-shelf" seismic data is considered to be seismic data

- that any other person had acquired (otherwise than as a consequence of performing work that resulted in the creation of the data) before the cost was incurred by the taxpayer,

- that any other person had a right to use before the cost was incurred by the taxpayer, or

- all or substantially all of which resulted from work performed more than one year before the cost was incurred by the taxpayer.

This amendment applies to costs incurred after March 5, 1996, other than costs incurred under an agreement in writing made before March 6, 1996.

Paragraph 66(12.6)(*d*) is amended to eliminate a reference to amounts renounced under subsection 66(12.64), strictly as a consequence of the repeal of that subsection. This amendment applies to renunciations made after 1998.

Subclauses 13(5) to (9)

ITA
66(12.601) to (12.602)

Subsections 66(12.601) and (12.602) of the Act allow oil and gas corporations to renounce up to $2 million of CDE per calendar year and have those expenses treated as CEE in the hands of flow-through shareholders. The CDE eligible for this treatment must generally be incurred in the 24-month period that begins on the day on which the relevant flow-through share agreement is entered into, and must be incurred on or before the effective date of the renunciation. (The effective date of a renunciation for an investor is a date specified by the flow-through corporation in the renunciation form. The investor is deemed to incur the amount renounced on this date.)

Eligible CDE is reduced to reflect assistance in respect of such CDE and overhead expenses prescribed under Part XII of the *Income Tax Regulations*. Subsection 66(12.601) is amended to clarify that

assistance in respect of CDE incurred after the effective date of a renunciation, as well as overhead expenses incurred after that date, do not reduce the CDE that can be flowed-through under the renunciation. This relieving amendment applies to expenses incurred after December 2, 1992.

Paragraph 66(12.601)(*a*.1) is introduced so that, for these purposes, a renouncing corporation's "taxable capital amount" at the time the consideration is given, cannot exceed $15 million. This amendment applies to renunciations made after March 5, 1996 (other than a renunciation made before 1999 in respect of consideration given before March 6, 1996 or given under an agreement in writing made before March 6, 1996 or under the terms of a prospectus, preliminary prospectus, registration statement, offering memorandum or notice filed before March 6, 1996 with a public authority in Canada in accordance with securities legislation of a province).

Subsection 66(12.6011) defines the expression "taxable capital amount". For a corporation with which no other corporations are associated, under subsection 66(12.6012) its taxable capital amount at any time is normally its taxable capital employed in Canada (as described below) for its last taxation year that ended more than 30 days before that time. Where there are corporations associated at such time with the issuing corporation, the taxable capital employed in Canada of each of the associated corporations for such taxation years is added in computing the issuing corporation's taxable capital amount. However, where the issuing corporation or any of the associated corporations has no taxation year ending more than 30 days in the past, the taxable capital employed in Canada of predecessor corporations (if any) of the issuing corporation and of the associated corporations is also taken into account under subsection 66(12.6013).

Under subsection 66(12.6012), a corporation's taxable capital employed in Canada for a taxation year is generally its taxable capital employed in Canada for the year, as determined under subsection 181.2(1) of the Act for the purposes of the Large Corporations Tax. However, a portion of a particular corporation's "investment allowance" (as determined under subsection 181.2(4)) may reflect the carrying cost at the end of the year of shares of the capital stock of, dividends payable by, or indebtedness of, another corporation that was associated with the particular corporation at the

end of the year but which is no longer so associated. This portion of the particular corporation's "investment allowance" is to be ignored for the purpose of determining the particular corporation's taxable capital employed in Canada for the year.

The rules for determining a particular corporation's taxable capital amount apply after March 5, 1996, except that a grandfathering rule allows the determination to be made in some cases as if other corporations associated with the particular corporation were not so associated.

The calculation of a corporation's taxable capital amount where there has been a series of amalgamations or mergers is illustrated in the following example:

EXAMPLE

Oilco enters into an agreement on July 31, 1998 under which it is to issue flow-through shares. Oilco was formed as a consequence of the amalgamation of Aco and Bco on July 20, 1998. Aco was formed as a consequence of the amalgamation of Cco and Dco on April 3, 1998. There are no corporations associated with Oilco on July 31, 1998. The relevant recent taxation year-ends are as follows:

Oilco	*No taxation year ended before July 31, 1998.*
Aco	*Only taxation year ended on July 20, 1998.*
Bco	*Taxation years ended on July 20, 1998 and December 31, 1997.*
Cco and Dco	*Last taxation years ended on April 3, 1998.*

Results:

1. Oilco's "taxable capital amount" on July 31, 1998 must be determined. Subsection 66(12.6013) applies for this purpose because Oilco has no taxation year that ended before July 1998 and it was created as a consequence of the amalgamation of predecessor corporations (Aco and Bco).

2. Under subsection 66(12.6013), Oilco's taxable capital employed in Canada for its last taxation year that ended before July 1998 is determined by adding the taxable capital employed in Canada of Aco and Bco for their last taxation years that ended before July 1998. In the case of Bco, the relevant taxation year is the one that ended on December 31, 1997.

3. Aco does not have a taxation year that ended before July 1998. Consequently, Aco's taxable capital employed in Canada for its last taxation year that ended before July 1998 is deemed to be sum of the taxable capital employed in Canada by Cco and Dco for their taxation years that ended on April 3, 1998.

4. Consequently, Oilco's taxable capital amount on July 31, 1998 is the total of

- *Bco's taxable capital employed in Canada for its taxation year ending on December 31, 1997,*

- *Cco's taxable capital employed in Canada for its taxation year ending on April 3, 1998, and*

- *Dco's taxable capital employed in Canada for its taxation year ending on April 3, 1998.*

Paragraph 66(12.602)(*a*) of the Act is amended to eliminate a reference to amounts renounced under subsection 66(12.64), strictly as a consequence of the repeal of that subsection. This amendment applies to renunciations made after 1998.

Paragraph 66(12.602)(*c*) of the Act is amended so that the annual limit for renunciations under subsection 66(12.601) is $1 million, rather than $2 million. This limit applies on a renunciation by renunciation basis. "Grandfathered" renunciations are subject to the

$2 million limit whereas "non-grandfathered" renunciations are subject to the $1 million limit. As a consequence, a non-grandfathered renunciation under subsection 66(12.601) in respect of expenditures made in a calendar year will generally be ineffective to the extent that the total renunciations (i.e. the current renunciation and total previous grandfathered and non-grandfathered renunciations in respect of the expenditures in the calendar year) of the issuing corporation and associated corporations exceed $1 million. This amendment applies to renunciations made after March 5, 1996, subject to the same grandfathering as is described above with respect to the introduction of paragraph 66(12.601)(*a*.1).

Subclause 13(10)

ITA
66(12.61)

Subsection 66(12.61) of the Act sets out the consequences of renunciations under subsections 66(12.6) and (12.601) of the Act. An amount renounced by a corporation under either subsection is generally treated as having being incurred by the flow-through share investor and as never having being incurred by the corporation. However, subsection 66(12.61) is subject to subsections 66(12.69) to (12.701) of the Act under which the failure to satisfy filing requirements can result in such expenditures being deemed not to have been incurred by an investor.

Subsection 66(12.61) is amended so that it is also subject to new subsection 66(12.702). This amendment is strictly consequential on the splitting of existing subsection 66(12.701) into two subsections, namely amended subsection 66(12.701) and new subsection 66(12.702).

This amendment applies to renunciations made after 1998.

Subclauses 13(11) to (13)

ITA
66(12.62)

Subsection 66(12.62) of the Act permits a principal-business corporation to renounce CDE to a flow-through shareholder. The

CDE eligible for this treatment must generally be incurred in the 24-month period that begins on the day on which the relevant flow-through share agreement is entered into, and must be incurred on or before the effective date of the renunciation. (The effective date of a renunciation for an investor is a date specified by the flow-through corporation in the renunciation form. The investor is deemed to incur the renounced CDE on this date.)

Eligible CDE is reduced to reflect assistance in respect of such CDE and overhead expenses prescribed under Part XII of the *Income Tax Regulations*. Subsection 66(12.62) is amended to clarify that assistance in respect of CDE incurred after the effective date of a renunciation, as well as overhead expenses incurred after that date, do not reduce the CDE that can be flowed-through under the renunciation. This relieving amendment applies to expenses incurred after February 1996.

Paragraph 66(12.62)(*b*.1) is introduced so that an amount cannot be renounced under subsection 66(12.62) on the basis of property expenses that are classified as CDE. The excluded property expenses are the costs of those Canadian resource properties (generally mineral rights and similar properties) described in paragraph (*e*) of the CDE definition and a partner's share of such costs. This amendment applies to renunciations made after March 5, 1996, subject to the same grandfathering as is described above with respect to the introduction of paragraph 66(12.601)(*a*.1).

Paragraph 66(12.62)(*d*) is amended to eliminate a reference to amounts renounced under subsection 66(12.64), strictly as a consequence of the repeal of that subsection. This amendment applies to renunciations made after 1998.

Subclause 13(14)

ITA
66(12.63)

Subsection 66(12.63) of the Act sets out the consequences of a renunciation under subsection 66(12.62) of the Act. An amount renounced by a corporation under that subsection is generally treated as having being incurred by the flow-through share investor and as never having being incurred by the corporation. However,

subsection 66(12.63) is subject to subsections 66(12.69) to (12.701) of the Act under which the failure to satisfy filing requirements can result in such expenditures being deemed not to have been incurred by an investor.

Subsection 66(12.63) is amended so that it is also subject to new subsection 66(12.702). This amendment is strictly consequential on the splitting of existing subsection 66(12.701) into two subsections, namely amended subsection 66(12.701) and new subsection 66(12.702).

This amendment applies to renunciations made after 1998.

Subclause 13(15)

ITA
66(12.64) and (12.65)

Subsections 66(12.64) and (12.65) of the Act permit a principal-business corporation to renounce Canadian oil and gas property expenses to flow-through shareholders.

Subsection 66(12.64) and (12.65) are being repealed.

This amendment applies to renunciations made after March 5, 1996, subject to the same grandfathering as is described above with respect to the introduction of paragraph 66(12.601)(*a*.1).

Subclauses 13(16) to (18) and subclause 75(1)

ITA
66(12.66)

Subsection 66(12.6) and (12.601) of the Act allow a corporation to renounce CEE and CDE, up to defined limits. Where certain conditions set out in subsection 66(12.66) of the Act are met, existing subsection 66(12.66) allows CEE or CDE incurred in the first 60 days of a calendar year to be treated as if it had been incurred at the end of the preceding calendar year. Where this subsection applies, the effective date of a renunciation made in a calendar year is the last day of the preceding calendar year.

Subsection 66(12.66) is amended to extend the "look-back" period from the 60th day of a calendar year to the end of that year. However, for the look-back rule to apply to renunciations in a calendar year, renunciations are required to be made in January, February or March of that year. Consequently, renunciations could be made in the first 3 months of a calendar year on the basis of qualifying CEE or qualifying CDE that an issuer plans to incur later in the year. For further detail on the operation of the new look-back rule and the more important rules related to the look-back rule, see the commentary on amendments to subsection 66(12.73), new Part XII.6 and new subsections 161(6.1) and 163(2.21) and (2.22) of the Act.

Paragraph 66(12.66)(*a*.1) is introduced so that, in order for the look-back rule to deem expenditures to be incurred at the end of a calendar year, the flow-through share agreement to which those expenditures relate must have been made in that year. This amendment is intended to simplify the operation of the new look-back rule while, at the same time, ensuring that the 24-month limit for the incurring of expenses under a flow-through share agreement is respected. The 24-month limit is set out in existing subsections 66(12.6) and (12.601).

Paragraph 66(12.66)(*b*) is amended to clarify that the CEE and CDE to which the look-back rule applies include a corporation's share as a partner of the qualifying CEE and CDE already explicitly described in existing paragraph 66(12.66)(*b*). Note, in this regard, that subsection 66(18) provides that a partner's share of a partnership expense in a fiscal period is considered to be incurred by the partner at the end of the fiscal period.

Paragraph 66(12.66)(*c*) is amended to clarify that it is not necessary for a share actually to be issued to a flow-through share investor by the end of the calendar year that includes the effective date of a renunciation. However, the flow-through share investor must pay consideration in money by the end of that year for the issue or future issue of such share.

Paragraph 66(12.66)(*d*) is amended so that the look-back rule does not apply unless the issuing corporation and the flow-through shareholder deal with each other at arm's length throughout the calendar year of the renunciation.

These amendments apply to expenses incurred after 1996, except that the relieving amendment to paragraph 66(12.66)(*b*) applies to expenses incurred after 1992. However, the amendments do not prevent renunciations of expenses incurred in January or February of 1997 pursuant to flow-through share agreements made in 1995.

In addition, it should be noted that the amendment to the postamble of subsection 66(12.66) (contained in subclause 75(1) of the amending legislation) is conditional on another bill being passed first. The conditional nature of the amendment is necessary to conform with parliamentary procedure, given that the other bill proposes to amend the same text. In the event that the condition is not satisfied, it is intended that the amendment to the postamble be reintroduced at the earliest opportunity.

Subclauses 13(19) to (25) and (31)

ITA
66(12.67)(*a*), (12.671)(*c*), (12.69), (12.6901),(12.691), (12.7), (12.7001), (12.701), (12.702), (12.71), (12.72), (12.741), (12.75)(*a*), (19) and (20)

The above-noted provisions contain a number of rules, including filing requirements, that apply in respect of renunciations under the flow-through share regime in the Act.

Paragraph 66(12.671)(*c*) of the Act is amended so that a cross-reference to subsection 66(12.7) is changed to subsection 66(12.7001). This amendment is strictly consequential on the movement of a part of the text of subsection 66(12.7) to new subsection 66(12.7001).

Subsection 66(12.72) of the Act, which explicitly provides the Minister of National Revenue authority to verify or ascertain various expenses, has been repealed. In view of the authority provided to the Minister under sections 231 to 231.3, subsection 66(12.72) is not considered to be necessary. The repeal of subsection 66(12.72) is effective on Royal Assent.

The remaining existing subsections have been amended to eliminate references to renunciations under subsection 66(12.64) of the Act, strictly as a consequence of the repeal of that subsection. There are

also a number of minor drafting changes reflected in the amendments, none of which reflect any changes in policy.

Subsections 66(12.6901), (12.7001) and (12.702) of the Act are introduced so that the consequences of a failure to file various forms are described separately from the obligation to file. The consequences of such a failure were previously set out in subsections 66(12.69), (12.7) and (12.701), respectively.

In addition, existing subsection 66(19) of the Act also has been split into two subsections (subsections 66(19) and (20)) for greater clarity.

Except as noted above, these amendments apply to renunciations made after 1998.

ITA
66(12.73)

Subsection 66(12.73) of the Act provides that, where a corporation renounces amounts under subsection 66(12.6), (12.601), (12.62) or (12.64) of the Act to one or more persons in excess of the amount that the corporation was entitled to renounce, the corporation must reduce the amount so renounced and file a statement with the Minister of National Revenue indicating the adjustments made. The statement must be filed within 30 days after notice in writing is forwarded to the issuing corporation by the Minister. The effect of the statement is to reduce the amount originally renounced by the excess identified in the statement. The Minister is permitted to make further reductions, to the extent that the issuing corporation has not fully identified the excess.

Subsection 66(12.73) is amended to eliminate, effective after 1998, a reference to renunciations under subsection 66(12.64) of the Act. This amendment is strictly consequential to the repeal of the latter subsection.

Subsection 66(12.73) is also amended so that it applies to excess renounced amounts on a renunciation-by-renunciation basis, given the need to provide for special treatment of renunciations of anticipated expenditures contemplated by the amendments to subsection 66(12.66) of the Act. This special treatment is necessary

because there are expected to be some cases where an issuing corporation fails to incur amounts that have been renounced by it pursuant to the new rules.

Subsection 66(12.73) is also amended to deal explicitly with renunciations that can be made, under the look-back rule in subsection 66(12.66), of expenditures that will be incurred after the renunciation is made. Where renunciations using the look-back rule are made, the issuing corporation is required to file the statement with the Minister, without any demand from the Minister. The statement is required to be filed before March of the calendar year following the calendar year of the renunciation. It should be noted, however, that adjustments under subsection 66(12.73) will not affect the issuing corporation's liability for tax under new Part XII.6. (Part XII.6 tax is described in the commentary below.)

Except as noted above, amended subsection 66(12.73) applies to renunciations purported to be made after 1996.

Subclause 13(26)

ITA
66(15)

"flow-through share"

Subsection 66(15) of the Act defines the expression "flow-through share".

References in the definition to renunciations of Canadian oil and gas property expenses are being eliminated, strictly as a consequence of the repeal of subsection 66(12.64).

This amendment applies to renunciations made after 1998.

Subclause 13(27)

ITA
66(15)

"foreign exploration and development expenses"

Subsection 66(15) of the Act defines the expression "foreign exploration and development expenses" (FEDE). It includes specified exploration expenses incurred in exploring for petroleum outside Canada or in searching for minerals outside Canada.

The expression is amended to clarify that a taxpayer's FEDE does not include certain amounts described in the definition.

This amendment is consistent with parallel changes to the definition "Canadian exploration expense" in subsection 66.1(6) of the Act. For further discussion, see the commentary below on the amendments to the definition "Canadian exploration expense".

These amendments apply to taxation years that end after ANNOUNCEMENT DATE.

Subclause 13(28)

ITA
66(15)

"principal-business corporation"

Subsection 66(15) of the Act defines a number of terms for the purpose of section 66. One of these definitions is that of "principal-business corporation". A principal-business corporation is given special treatment under the Act, including the ability to renounce CEE to investors in flow-through shares issued by it.

The definition "principal-business corporation" is expanded to include corporations whose principal business is any of the existing businesses listed in paragraphs 66(15)(*a*) to (*g*), the generation of energy using Class 43.1 property and the development of projects where it is reasonably expected that at least 50% of the capital cost of the depreciable property to be used in each project would be the

capital cost of Class 43.1 property. For further detail, see the commentary on the new definition "Canadian renewable and conservation expense" in subsection 66.1(6).

This amendment applies after ANNOUNCEMENT DATE.

Subclause 13(29)

ITA
66(16)

Subsection 66(16) of the Act provides that a partnership is deemed to be a person having a taxation year that coincides with its fiscal period. The provision applies for a number of stated purposes linked with the flow-through share regime.

Subsection 66(16) is amended so that the rule also applies for the purposes of subsections 66(12.67) to (12.73) of the Act. This is of relevance to the interpretation of amended subsections 66(12.701) and (12.73) of the Act in which references are made to persons.

This amendment applies to fiscal periods that end after 1995.

Subclause 13(30)

ITA
66(18)

Subsection 66(18) of the Act provides that, for the purposes of most of the resource taxation rules, a partner's share of resource expenditures incurred in a fiscal period is considered to have been incurred by the partner at the end of the fiscal period.

Subsection 66(18) is amended so that it also applies for the purposes of specified provisions in new Part XII.6 of the Act.

This amendment applies to fiscal periods that end after 1996.

Clause 14

Amount to be Included in Income

ITA
66.1

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

Subclauses 14(1) and (2)

ITA
66.1(2) and (3)

Subsection 66.1(2) of the Act generally limits the deduction for a taxation year of CEE balances of a principal-business corporation to the amount of the corporation's income for the year. Taxpayers that are not principal-business corporations may generally deduct their full CEE balances under subsection 66.1(3).

Subsection 66.1(2) is amended to exclude from its application certain principal-business corporations involved with renewable energy and conservation projects. More specifically, the principal-business corporations excluded are those that qualify as such only because of the amendments to the definition "principal-business corporation" in subsection 66(15) that are described in the commentary above.

Subsection 66.1(3) is amended so that the principal-business corporations now excluded from the application of subsection 66.1(2) are generally permitted to deduct their full CEE balances.

The purpose of these amendments is to allow excluded principal-business corporations to deduct their full CEE balances for taxation years during which the control of such corporations is acquired by other persons. These amendments recognize that the excluded principal-business corporations would not be expected to have Canadian resource properties. This is relevant because CEE balances are generally eliminated under subsection 66.7(10) of the Act on an acquisition of control of the corporation and, instead, deductions of "successor" CEE are permitted only to the extent of streamed income from Canadian resource properties owned

immediately before the acquisition of control. Because of these amendments, excluded principal-business corporations may create non-capital losses using their CEE balances. However, the use of these non-capital losses after the acquisition of control would be restricted because of subsection 111(5) of the Act and related rules.

These amendments apply to taxation years ending after ANNOUNCEMENT DATE.

Subclauses 14(3) and (4)

ITA
66.1(6)

"Canadian exploration expense"

Subsection 66.1(6) of the Act defines various terms for the purposes of section 66.1.

The definition "Canadian exploration expense" (CEE) is amended by including as such Canadian renewable and conservation expenses (CRCE), including a partner's share of CRCE incurred by a partnership. This amendment applies after ANNOUNCEMENT DATE.

The definition is also amended to clarify that a taxpayer's CEE does not include the cost to the taxpayer of any depreciable property of a prescribed class. This amendment, as well as the related amendments to the definitions "Canadian development expense" and "foreign exploration and development expenses", are for greater certainty. However, the amendment does not apply to any expense that qualifies as CRCE.

As a consequence of this amendment, it is clear that the determination of whether property is depreciable property is generally made before the determination of whether the cost of the property qualifies as CEE. In the event that the property is depreciable property, its cost will generally not be CEE. In this connection, it is noted that new subsection 13(7.5) of the Act generally ensures depreciable property treatment for costs associated with the building of roads and similar projects.

The definition is also amended to clarify that a taxpayer's CEE does not include

- an expenditure incurred at any time after the commencement of production (as defined in subsection 66(15)) from a Canadian resource property of the taxpayer in order to evaluate the feasibility of a method of recovery of, or to assist in the recovery of, petroleum, natural gas or related hydrocarbons from a portion of a natural reservoir to which that Canadian resource property relates, or

- an expenditure incurred at any time for the purpose of injecting any substance to assist in the recovery of petroleum, natural gas or related hydrocarbons from a natural reservoir.

These expenditure are generally expected to be fully deductible in computing a taxpayer's income.

Consequential on the above changes, the definition is also amended to ensure that a taxpayer's share of a cost or expenditure described above that is incurred by a partnership is likewise not taken into account for the purposes of determining a taxpayer's CEE.

Except as noted above, these amendments apply to taxation years that end after ANNOUNCEMENT DATE.

Subclause 14(5)

ITA
66.1(6)

"Canadian renewable and conservation expense"

The definition "Canadian renewable and conservation expense" is introduced in subsection 66.1(6) of the Act so that CRCE has the meaning assigned by the *Income Tax Regulations*. For this purpose, the Technical Guide on this topic published by the Department of Natural Resources is to apply conclusively with respect to engineering and scientific matters in the determination of whether an expense meets the criteria set out in the regulations.

In general terms, it is proposed to prescribe as CRCE certain intangible development costs associated with projects for which the required equipment primarily consists of Class 43.1 assets. Draft regulations defining CRCE are included in Appendix E to these explanatory notes.

Because of this amendment, CRCE can be renounced under subsection 66(12.6) of the Act by a principal-business corporation to investors in flow-through shares issued by it. The definition "principal-business corporation" in subsection 66(15) is being amended to allow corporations that typically incur CRCE to issue flow-through shares.

This amendment applies after ANNOUNCEMENT DATE.

Subclause 14(6)

ITA
66.1(8)

Subsection 66.1(8) of the Act relates to flow-through share agreements that were entered into before 1987. The measure is being repealed because it is no longer necessary. A similar rule is now provided in subsection 66(12.66).

This amendment applies on Royal Assent.

Clause 15

Definitions

ITA
66.2(5)

"Canadian development expense"

Subsection 66.2(5) of the Act defines the expression "Canadian development expense" (CDE).

The definition is amended to clarify that a taxpayer's CDE does not include a cost to the taxpayer of any depreciable property of a prescribed class.

This amendment is consistent with parallel changes to the definition "Canadian exploration expense" in subsection 66.1(6) of the Act and the definition "foreign exploration and development expenses" in subsection 66(15) of the Act. For further discussion, see the commentary on the amendments to the definition "Canadian exploration expense" in subsection 66.1(6).

Consequential on this change, the definition is also amended to ensure that a taxpayer's share of a cost or expenditure described above that is incurred by a partnership is likewise not taken into account for the purposes of determining the taxpayer's CDE.

These amendments apply to taxation years that end after ANNOUNCEMENT DATE.

Clause 16

Exploration and Development Expense – Successor Rules

ITA
66.7(10)

Under subsection 66.7(10) of the Act, a corporation is treated as a successor for the purposes of the successor rules in section 66.7 after an acquisition of control of the corporation. However, this rule does not apply for the purposes of the flow-through share renunciation rules.

Subsection 66.7(10) is amended to eliminate a reference to renunciations under subsection 66(12.64), strictly as a consequence of the repeal of that subsection.

This amendment applies to taxation years that begin after 1998.

Clause 17

Definition of "eligible property"

ITA
85(1.1)(*b*)

Subsection 85(1.1) of the Act describes the types of property (which are referred to as "eligible property") that may be transferred to a corporation under subsection 85(1). Under paragraph 85(1.1)(*b*), "eligible property" includes capital property that is real property or an interest in such property owned by a non-resident insurer where the property is, within the meaning assigned by subsection 138(12) of the Act, "property used by it in the year in, or held by it in the year in the course of" carrying on an insurance business in Canada.

The definition "property used by it in the year in, or held by it in the year in the course of" carrying on an insurance business in subsection 138(12) is replaced by the definition "designated insurance property". Consequential upon that amendment, paragraph 85(1.1)(*b*) is amended so that it refers to the new definition "designated insurance property".

The amendment to paragraph 85(1.1)(*b*) applies to dispositions that occur in an insurer's 1996 or subsequent taxation year.

Clause 18

Amalgamations

ITA
87

Section 87 of the Act provides rules which apply on the amalgamation of two or more taxable Canadian corporations to create a new corporation. The new corporation is generally treated as a continuation of the predecessor corporations for the purposes of the Act.

Subclause 18(1)

ITA
87(2)(*d*)(ii)(C)

Paragraph 87(2)(*d*) of the Act sets out rules which apply on the transfer of depreciable property to a corporation formed on an amalgamation of predecessor corporations to which section 87 applies. Clause 87(2)(*d*)(ii)(C) contemplates that, after such an amalgamation, there could be a transfer of depreciable property to which subsection 13(5) of the Act applies. Where this is the case, the calculation under subparagraph 13(5)(*b*)(ii) is made on the basis that the predecessor corporation is the same corporation as the new corporation.

Clause 87(2)(*d*)(ii)(C) is amended to ensure that it applies for the purposes of making a calculation under amended subparagraph 13(5)(*b*)(ii). This amendment is strictly consequential to the amendments to subsection 13(5) that are described in the commentary above.

This amendment applies to taxation years that begin after 1996.

Subclauses 18(2) and (3)

ITA
87(2)(*oo*) and (*oo*.1)

Paragraph 87(2)(*oo*) of the Act is relevant for the purposes of determining the extent of a new corporation's eligibility to earn new additional 15% investment tax credits for SR&ED and to earn new refundable investment tax credits. Paragraph 87(2)(*oo*) also applies for the purpose of determining a new corporation's eligibility for the one-month extension to pay taxes under paragraph 157(1)(*b*) of the Act. For all of these purposes, the degree to which a new corporation is eligible for a taxation year can depend on the new corporation having a sufficiently small taxable income for a preceding taxation year.

More specifically, under subsection 127(10.1) of the Act, an amount up to 15% of a new corporation's SR&ED expenditures is added in computing the new corporation's investment tax credit. However, the

additional tax credit is capped by an amount equal to 15% of the new corporation's "expenditure limit". A corporation's "expenditure limit" is a maximum of $2 million, but is reduced by $10 for each $1 that the total taxable income of the corporation and corporations associated with it for specified previous taxation years exceeds $200,000. As a consequence of legislative changes that applied to taxation years that begin after 1995, the previous taxation years so specified for a corporation can depend on whether or not the corporation is associated with any other corporation.

In the case of determining eligibility for refundable investment tax credits and the one-month extension to pay taxes under paragraph 157(1)(*b*) of the Act, the total taxable income of a corporation and corporations associated with it is sufficiently small if it does not exceed the business limit (as determined under section 125 of the Act) of those corporations for specified previous taxation years. With respect to the eligibility for refundable investment tax credits for taxation years that begin after 1995, the previous taxation years specified in applying the definition "qualifying corporation" in subsection 127.1(2) to a corporation depends on whether or not the corporation is associated with any other corporation. (Note, in addition, that a similar rule with respect to associated corporations is to apply under amended subparagraph 157(1)(*b*)(i) to the one-month extension to pay taxes for taxation years that end after 1997.)

For all of these purposes, existing paragraph 87(2)(*oo*) deems the new corporation to have had a taxation year which immediately preceded its first taxation year and to have had taxable income for that year equal to the total of its predecessors' taxable incomes for their taxation years that ended as a consequence of the amalgamation. The new corporation's business limit for the deemed taxation year is computed in a similar fashion.

Paragraph 87(2)(*oo*) is being amended and new paragraph 87(2)(*oo*.1) is being added, mostly to take into account past legislative changes to the investment tax credit rules and current legislative changes to the flow-through share rules. Similar changes are being made to a parallel rule for windings-up in paragraph 88(1)(*e*.8) of the Act.

Amended paragraph 87(2)(*oo*) now applies only for the purpose of determining eligibility for the additional SR&ED investment tax credit. For the purpose of determining a corporation's "expenditure

limit" under subsection 127(10.2) for a taxation year, amended paragraph 87(2)(*oo*) provides that the new corporation's taxable income for a specified previous taxation year is deemed to be the sum of the taxable incomes of its predecessors for taxation years that end as a consequence of the amalgamation. This specified taxation year is consistent with the taxation year specified under subsection 127(10.2). Amended paragraph 87(2)(*oo*) does not provide a rule to determine the new corporation's business limit, as it is the new corporation's current business limit that is relevant under subsection 127(10.2) in determining its "expenditure limit". Except as noted below, amended paragraph 87(2)(*oo*) applies to amalgamations that occur after 1995.

New paragraph 87(2)(*oo*.1) applies for the purpose of determining a new corporation's eligibility for refundable investment tax credits and for the one-month extension to pay taxes. The existing reference to paragraph 127.1(2)(*a*) in paragraph 87(2)(*oo*) is replaced by a reference in new paragraph 87(2)(*oo*.1) to the definition of "qualifying corporation" set out in subsection 127.1(2). This change reflects the restructuring of subsection 127.1(2) which led to the introduction of that definition.

New paragraph 87(2)(*oo*.1) provides that a new corporation's taxable income for a specified previous taxation year is deemed to be the sum of its predecessor corporations' taxable incomes for taxation years that end as a consequence of the amalgamation. New paragraph 87(2)(*oo*.1) also provides a similar rule for the computation of the new corporation's business limit for the specified previous taxation year. This specified taxation year is consistent with the taxation year specified under the definition "qualifying corporation" in subsection 127.1(2) and under subparagraph 157(1)(*b*)(i). Except as noted below, new paragraph 87(2)(*oo*.1) applies to amalgamations that occur after May 23, 1985 in order to reflect the repeal of former paragraph 127.1(2)(*a*).

New paragraph 87(2)(*oo*.1) makes references to a corporation's "business limit". It is noted that this expression is now defined in subsection 248(1) of the Act to be a corporation's business limit determined under section 125.

Both paragraphs 87(2)(*oo*) and (*oo*.1) now provide that, for all of the purposes described above, taxable income for a taxation year is determined before taking into consideration "specified future tax

consequences" for the year. "Specified future tax consequences" (which is described in greater detail in its new definition in subsection 248(1)) refers in this context to adjustments arising because of corrections of certain amounts renounced in connection with the issue of flow-through shares.

Paragraphs 87(2)(*oo*) and (*oo*.1) also are now structured so that they apply not only to a new corporation but to each corporation associated with the new corporation. For example, an associated corporation's eligibility for the refundable investment tax credit may be reduced or eliminated because of taxable income deemed to have been earned by a new corporation under new paragraph 87(2)(*oo*.1). This amendment applies only to amalgamations that occur after 1996.

Subclause 18(4)

ITA
87(2.2)

Subsection 87(2.2) of the Act deals with the amalgamation of two or more corporations where one or more of the predecessor corporations was an insurer. Where this occurs, the resulting corporation is treated as a continuation of each of the predecessor insurance corporations for the purposes of section 138 of the Act and certain other provisions of the Act relating to insurers that are listed in subsection 87(2.2). This subsection is amended to add references to new paragraph 12(1)(*e*.1) and new subsection 20(22) of the Act dealing with an insurer's negative policy reserves in respect of its insurance businesses, other than life insurance businesses.

Amended subsection 87(2.2) applies to amalgamations occurring after 1995.

Subclause 18(5)

ITA
87(4.4)

Subsection 87(4.4) of the Act applies where a corporation that has entered into a flow-through share arrangement with a person amalgamates with another corporation. The rules in

subsection 87(4.4) generally enable the corporation formed as a consequence of the amalgamation to renounce expenses incurred after the amalgamation to the person.

Subsection 87(4.4) is amended to eliminate a reference to renunciations under 66(12.64) of the Act, strictly as a consequence of the repeal of the latter subsection. This amendment applies to amalgamations that occur after 1998.

Subsection 87(4.4) is also amended so that it applies for the purposes of determining tax under new Part XII.6 of the Act. This amendment applies to amalgamations that occur after 1995.

Clause 19

Winding-up of a Corporation

ITA
88

Section 88 deals with the tax consequences arising from the winding-up of a corporation.

Subclauses 19(1) and (2)

ITA
88(1)(*e*.8) and (*e*.9)

Subsection 88(1) of the Act provides rules which apply where a subsidiary has been wound-up into its parent corporation, provided that both corporations are taxable Canadian corporations and the parent owns not less than 90% of the issued shares of each class of the subsidiary's capital stock.

Paragraph 88(1)(*e*.8) is relevant for the purposes of determining the extent of a parent corporation's eligibility to earn new additional 15% investment tax credits for SR&ED and to earn new refundable investment tax credits. Paragraph 88(1)(*e*.8) also applies for the purpose of determining a parent corporation's eligibility for the one-month extension to pay taxes under paragraph 157(1)(*b*) of the Act. For all of these purposes, the degree to which a parent

corporation is eligible for a taxation year can depend on the parent corporation having a sufficiently small taxable income for a preceding taxation year. For further detail in this regard, see the commentary above on the amendments to paragraphs 87(2)(*oo*) and (*oo*.1).

For all of these purposes, existing paragraph 88(1)(*e*.8) adds an amount to the parent corporation's taxable income for a taxation year during which it received assets from the subsidiary on the winding-up. The added amount is equal to the subsidiary's total taxable incomes for its taxation years ending in the calendar year in which the taxation year of receipt ended. The parent corporation's business limit for the taxation year of receipt is computed in a similar manner.

Paragraph 88(1)(*e*.8) is amended and new paragraph 88(1)(*e*.9) is added, mostly to take into account past legislative changes to the investment tax credit rules and current legislative changes to the flow-through share rules. Similar changes are being made to a parallel rule for amalgamations in paragraph 87(2)(*oo*).

Amended paragraph 88(1)(*e*.8) now applies only for the purpose of determining eligibility for the additional SR&ED investment tax credit. For the purpose of determining a corporation's "expenditure limit" under subsection 127(10.2) of the Act for a taxation year that begins after the receipt by the parent corporation of an asset of the subsidiary on its winding-up, amended paragraph 88(1)(*e*.8) provides that the parent corporation's taxable income for a specified previous taxation year is increased by the taxable income of its subsidiary for the subsidiary's taxation years that end in the same calendar year as the specified previous taxation year. The specified taxation year is consistent with the taxation year specified under subsection 127(10.2). Amended paragraph 88(1)(*e*.8) does not provide a rule to determine the parent corporation's business limit, as it is the parent corporation's current business limit that is relevant under subsection 127(10.2) in determining its "expenditure limit". Except as noted below, amended paragraph 88(1)(*e*.8) applies for the purpose of determining "expenditure limits" for investment tax credit purposes for taxation years that begin after 1995.

New paragraph 88(1)(*e*.9) applies for the purposes of determining a parent corporation's eligibility for refundable investment tax credits and the one-month extension for paying taxes for a taxation year that

begins after the parent corporation receives on asset of the subsidiary on its winding-up. For these purposes, new paragraph 88(1)(*e*.9) provides that a parent corporation's taxable income for a specified previous taxation year is increased by the taxable income of its subsidiary for the subsidiary's taxation years that end in the same calendar year as the specified previous taxation year. New paragraph 88(1)(*e*.9) also provides a similar rule for the computation of the parent corporation's business limit for the specified previous taxation year. The specified taxation year is consistent with the taxation year specified under the definition "qualifying corporation" in subsection 127.1(2) and under subparagraph 157(1)(*b*)(i). Except as noted above, for drafting convenience new paragraph 88(1)(*e*.9) applies to windings-up that begin after May 23, 1985.

New paragraph 88(1)(*e*.9) makes references to a corporation's "business limit". It is noted that this expression is now defined in subsection 248(1) of the Act as a corporation's business limit determined under section 125 of the Act.

Paragraphs 88(1)(*e*.8) and (*e*.9) both now provide, for the purposes described above, that taxable income for a taxation year is determined before taking into consideration "specified future tax consequences" for the year. "Specified future tax consequences" (which is described in greater detail in its new definition in subsection 248(1)) refers to adjustments arising because of the carryback of losses or similar amounts or because of corrections of certain amounts renounced in connection with the issue of flow-through shares.

Paragraphs 88(1)(*e*.8) and (*e*.9) also are now structured so that they apply not only to a parent corporation but to each corporation (other than the subsidiary) associated with the parent corporation. For example, an associated corporation's eligibility for the refundable investment tax credit may be reduced or eliminated because of taxable income deemed to have been earned by a parent corporation under new paragraph 88(1)(*e*.9). This amendment applies to windings-up that begin after 1996.

Paragraphs 88(1)(*e*.8) and (*e*.9) are also now structured to operate once the parent corporation receives an asset of the subsidiary on its winding-up in a taxation year of the parent corporation. The parent corporation's eligibility for the tax benefits described above for each subsequent taxation year is consequently affected by the subsidiary's

taxable income for a specified taxation year. In order to avoid double-counting in the event that a winding-up continues over a number of taxation years, the subsidiary's taxable income and business limits for its taxation years that end after the first receipt of assets by the parent corporation on the winding-up, are deemed to be nil.

Subclause 19(3)

ITA
88(1)(*g*)(i)

Paragraph 88(1)(*g*) deals with the winding-up of a corporation that is a subsidiary into its parent. Subparagraph 88(1)(*g*)(i) treats the parent corporation as a continuation of a subsidiary that is an insurance corporation for the purposes of certain provisions relating to insurers listed in subparagraph 88(1)(*g*)(i). This subparagraph is amended to add references to proposed new paragraph 12(1)(*e*.1) and new subsection 20(22) of the Act dealing with an insurer's negative policy reserves in respect of its insurance businesses, other than life insurance businesses.

Amended subparagraph 88(1)(*g*)(i) applies to windings-up that begin after 1995.

Clause 20

Application of Certain Provisions to Trusts Not Resident in Canada

ITA
94

Section 94 of the Act provides for special rules to tax the passive income earned by certain trusts that are not resident in Canada. In the case of trusts under which the amount of the income or capital to be distributed to beneficiaries does not depend on the exercise of discretion, the rules parallel the foreign accrual property income rules in respect of non-resident corporations.

Subclause 20(1)

ITA
94(1)(*c*)(i)

Subparagraph 94(1)(*c*)(i) of the Act treats certain non-resident discretionary trusts as residents of Canada for the purpose of Part I of the Act.

Subparagraph 94(1)(*c*)(i) is amended so that it also applies for the purposes of new sections 233.3 and 233.4, which set out reporting obligations in respect of foreign property and foreign affiliates of taxpayers. In conjunction with the rules in sections 233.3 and 233.4 of the Act, this amendment has the effect of extending the foreign reporting obligations under those sections to the discretionary trusts referred to in the subparagraph.

This amendment applies after 1995.

Subclause 20(2)

ITA
94(1)(*d*)

Paragraph 94(1)(*d*) of the Act treats certain non-resident trusts as non-resident corporations that are controlled by certain beneficiaries of such trusts. As well, it deems the non-resident trust to be a corporation with a single class of shares divided into 100 issued shares. Each beneficiary is considered to own a proportion of the issued shares that is commensurate with the fair market value of the beneficiary's beneficial interest in the trust.

Paragraph 94(1) is amended so that it applies for the purpose of section 233.4 of the Act, thus ensuring that the new reporting requirements in respect of foreign affiliates apply in respect of non-resident trusts that are foreign affiliates because of paragraph 94(1)(*d*).

This amendment applies after 1995.

Clause 21

Partnerships and Their Members

ITA
96(1)(*d*)

Under subsection 96(1) of the Act, the income earned and the losses incurred by a partnership are generally calculated at the partnership level and attributed to partners in accordance with their respective interests. However, the income or loss of a partnership is computed without reference to a number of provisions including the resource allowance under paragraph 20(1)(*v*.1) of the Act.

Paragraph 96(1)(*d*) is amended so that the income inclusion under paragraph 12(1)(*z*.5) of the Act is likewise not taken into account. The amount included in computing income under paragraph 12(1)(*z*.5), like the resource allowance itself, is computed at the partner level rather than the partnership level. Consequently, it is appropriate that paragraph 12(1)(*z*.5) be ignored at the partnership level.

This amendment applies to fiscal periods that begin after 1996.

Clause 22

Charitable Gifts Made by Corporations

ITA
110.1(1)(*a*)

Section 110.1 of the Act contains the provisions governing the tax treatment of gifts made by corporations to charities and certain other entities.

Subsection 110.1(1) of the Act provides a deduction in computing taxable income in respect of gifts made by corporations to registered charities and certain other entities. The deduction is generally limited to 20% of the corporation's net income in a year, except where the

gift is made to the Crown or where it is an ecological gift or a gift of cultural property. Donors may carry unused claims forward for up to five years.

This amendment to subsection 110.1(1) implements changes to the 20% income limit. The limit is raised to 50% of a corporation's income (which, in the case of credit unions, is computed without reference to any deductions under subsection 137(2) of the Act) plus an additional 50% of any taxable capital gains that have arisen from gifts of property made by the corporation in the year to a charity or other entity specified in subsection 110.1(1).

This amendment applies to the 1996 and subsequent taxation years.

Clause 23

Non-resident's taxable income

ITA
115(1)(*b*)(ii.1)

Paragraph 115(1)(*b*) of the Act lists the types of property (which are referred to as "taxable Canadian property") in respect of which taxable capital gains and allowable capital losses are included in the determination of a non-resident's taxable income earned in Canada. Subparagraph 115(1)(*b*)(ii.1) is amended as a consequence of the replacement of the definition of "property used by it in the year in, or held by it in the year in the course of" in subsection 138(12) of the Act with the new definition of "designated insurance property".

This amendment applies to the 1996 and subsequent taxation years.

Clause 24

Annual Adjustment of Deductions and Other Amounts

ITA
117.1

Section 117.1 of the Act provides for the indexing of various amounts, including the amounts on which the personal tax credits are based.

Subclause 24(1)

ITA
117.1(1)(*a*)

Paragraph 117.1(1)(*a*) of the Act provides for the indexing of amounts used in the calculation of the personal tax credits contained in subsection 118(1) of the Act. This amendment to the English version of paragraph 117.1(1)(*a*), which does not change the substance of the provision, modifies the language used in order to correctly reflect the formula used in subsection 118(1).

This amendment applies on Royal Assent.

Subclause 24(2)

ITA
117.1(1)

Subsection 117.1(1) provides the basis on which various amounts are to be indexed. This amendment to the subsection is consequential on the amendments to subsection 118(1) that increase the amount on which the tax credit for an infirm dependant is based. This amendment to subsection 117.1(1) ensures that those increased amounts will be subject to indexation after 1996, in the same manner that other amounts used in the calculation of the various personal tax credits are indexed.

This amendment applies to the 1996 and subsequent taxation years.

Subclause 24(3)

ITA
117.1(2)

Subsection 117.1(2) of the Act provides for the indexation of the income threshold for a spouse or a wholly dependent person used in calculating the married and equivalent-to-married tax credits in subsection 118(1) of the Act. This amendment to the English version of subsection 117.1(2), which does not change the substance of the provision, modifies the language used in order to correctly reflect the formula used in subsection 118(1).

This amendment applies on Royal Assent.

Clause 25

Personal Credits

ITA
118

Section 118 of the Act provides for the calculation of various personal tax credits. These include the single, married status, equivalent-to-married, infirm dependant, age and pension tax credits.

Subclause 25(1)

ITA
118(1)

This amendment to the French version of subsection 118(1) of the Act is consequential on the addition of paragraph (*e*) to the section. It applies to the 1996 and subsequent taxation years.

Subclause 25(2)

ITA
118(1)(*a*)

Paragraph 118(1)(*a*) of the Act deals with the tax credit available to married individuals who support their spouses. This amendment clarifies that the credit is only available where an individual at any time in the year is supporting his or her spouse and is living with that spouse. Thus, the credit may be available in a year in which an individual marries, and may also be available in the year in which an individual separates or divorces from a spouse. However, the credit is not available to individuals who, for example, may support their spouses through the payment of support amounts, in years following the year in which a separation or divorce takes place and throughout which the two individuals live separate and apart.

This amendment applies to the 1997 and subsequent taxation years.

Subclause 25(3)

ITA
118(1)(*b*)

Paragraph 118(1)(*b*) of the Act deals with the equivalent-to-married credit. This credit is available to individuals who support dependents other than their spouses.

This amendment to paragraph 118(1)(*b*) clarifies that an individual may claim an equivalent-to-married tax credit in certain cases where he or she may otherwise qualify for the married tax credit but does not claim the married tax credit. This amendment ensures that, for example, in the year in which an individual divorces or separates from a spouse, the individual may claim either a married tax credit in respect of the spouse or an equivalent-to-married tax credit in respect of a dependent child residing with the individual.

This amendment applies to the 1997 and subsequent taxation years.

Subclauses 25(4) and (5)

ITA
118(1)(*d*)

Paragraph 118(1)(*d*) of the Act deals with the tax credit available to an individual in respect of a dependant who is over the age of 17 and who is dependent on the individual because of mental or physical infirmity. The credit is calculated as 17 per cent of the base amount of $1,583, and is reduced by 17 per cent of every dollar by which the dependant's income exceeds $2,690. Thus, the maximum credit available is $270, which is reduced to zero when the dependant's income reaches $4,273.

This amendment to paragraph 118(1)(*d*) increases the maximum credit available by increasing the base amount on which the credit is calculated from $1,583 to $2,353, for a maximum credit of $400, and by increasing the income level at which the credit begins to be reduced from $2,690 to $4,103. These amounts are indexed for years after 1996. As a result, the credit will be available where a dependant's income is less than $6,456. These changes are reflected in the modification of the formula in paragraph 118(1)(*d*), so that the credit is calculated on the amount by which $6,456 exceeds the greater of $4,103 and the dependant's income for the year.

The changes apply to the 1996 and subsequent taxation years.

Subclause 25(6)

ITA
118(1)(*e*)

New paragraph 118(1)(*e*) is added to the Act as a consequence of the changes to the credit for infirm dependants in paragraph 118(1)(*d*).

An individual with an infirm dependant over the age of 17 may qualify for both the equivalent-to-married tax credit under paragraph 118(1)(*b*) and the credit in respect of an infirm dependant under paragraph 118(1)(*d*). In such circumstances, the rules in paragraph 118(4)(*c*) of the Act restrict the individual to claiming a credit under paragraph 118(1)(*b*).

As a result of the increase to the income level at which the credit in respect of an infirm dependant in paragraph 118(1)(*d*) is reduced, it is possible that the credit available under paragraph 118(1)(*d*) will exceed the credit available under paragraph 118(1)(*b*). This will occur when the income of the dependant in respect of whom a credit is available exceeds $3,565. In order to ensure that in these cases the individual claimant is not penalized by having to claim a lesser credit under paragraph 118(1)(*b*), new paragraph 118(1)(*e*) provides that the amount available under paragraph 118(1)(*b*) will be increased by the amount by which the amount determined under paragraph 118(1)(*d*) exceeds the amount determined under paragraph 118(1)(*b*).

New paragraph 118(1)(*e*) applies to the 1996 and subsequent taxation years.

Subclause 25(7)

ITA
118(4)

Subsection 118(4) of the Act provides rules governing the tax credits available under subsection 118(1). These amendments to the English version of subsection 118(4), which do not change the substance of the provision, modify the language used in order to correctly reflect the formula used in subsection 118(1).

These amendments applies on Royal Assent.

Subclause 25(8)

ITA
118(5)

Subsection 118(5) of the Act provides that an individual who is entitled to a deduction under paragraph 60(*b*), (*c*) or (*c*.1) of the Act in respect of a support payment for the maintenance of a spouse or child is not also entitled to claim a credit under section 118 in respect of that spouse or child.

Subsection 118(5) is amended as a consequence of the changes to the treatment of child support. As amended, subsection 118(5) provides that an individual is not entitled to claim a credit under

subsection 118(1) in respect of a person if the individual is required to pay a support amount to his or her spouse or former spouse for that person and the individual either is living separate and apart from the spouse or former spouse throughout the year because of marriage breakdown or is claiming a deduction for support payments.

Under this new wording, where an individual is required to make child or spousal support payments in years following the year of marriage breakdown, no credits under subsection 118(1) will be available to the individual in respect of the spouse or child, even in cases where such support payments are not made or, if made, are not deductible. In the year in which a marriage breakdown occurs, an individual may be able to claim credits under subsection 118(1) if he or she does not claim a deduction for support payments.

These amendments apply to the 1997 and subsequent taxation years.

Subclause 25(9)

ITA
118(6)

Subsection 118(6) of the Act provides the definition of a dependant for the purposes of paragraphs 118(1)(*d*) and 118(4)(*e*) of the Act. This amendment adds a reference to new paragraph 118(1)(*e*) and also modifies the language of the subsection in order to correctly reflect the formula used in subsection 118(1).

This amendment applies to the 1996 and subsequent taxation years.

Clause 26

Charitable Gifts Made by Individuals

ITA
118.1

Section 118.1 of the Act provides rules for determining the tax credit available to individuals in respect of gifts made to charities and certain other entities.

The definition "total gifts" in subsection 118.1(1) of the Act determines the amount upon which an individual's tax credit for gifts to various entities is based. The credit is generally based on 20% of the individual's income for a year, except where the gift is made to the Crown or is an ecological gift or a gift of cultural property. Donors may carry unused claims forward for up to five years. As well, subsection 118.1(4) of the Act, which provides that gifts made in the year an individual dies and not claimed in that year are to be treated as if they were made in the immediately preceding year, permits an additional one-year carryback under such circumstances.

This amendment to the definition "total gifts" in subsection 110.1(1) implements changes to the 20% income limit. First, in the year an individual dies, and for purposes of gifts made in that year and carried back to the year immediately preceding death, the limit is raised from 20% to 100% of the individual's income in each of those years. In all other cases, the limit is raised to 50% of the individual's income for the year plus an additional 50% of any taxable capital gains that have arisen from gifts of property made in the year by the individual to a charity or other entity specified in the definition "total charitable gifts" in subsection 118.1(1) of the Act. This limit is reduced by 50% of the amount of any capital gains exemption that the individual has deducted in respect of such capital gains. The effect of these provisions is that the additional 50% in respect of gifts of appreciated capital property will only be available to the extent that the associated capital gain has been included in the individual's taxable income in the year the gift is given.

This amendment applies to the 1996 and subsequent taxation years, and, where an individual dies in 1996, to the individual's 1995 taxation year.

Clause 27

Disability tax credit

ITA
118.3(2)

Section 118.3 of the Act provides a tax credit for individuals who have a severe and prolonged mental or physical impairment.

Subsection 118.3(2) contains criteria to determine the entitlement of a supporting individual of a disabled person to claim that person's unused disability tax credit. As a part of that determination, reference is made, in subparagraphs 118.3(2)(*a*)(i) and (ii), to paragraphs 118(1)(*b*) and (*d*) of the Act.

These amendments to the English version of paragraphs 18.3(2)(*a*)(i) and (ii) do not change the substance of the provision. They simply modify the language used in referring to paragraphs 118(1)(*b*) and (*d*) to correctly reflect the formula used in subsection 118(1).

These amendments apply on Royal Assent.

Clause 28

Education Tax Credit

ITA
118.6(2)

Section 118.6 of the Act provides rules for determining an individual's education tax credit.

Subsection 118.6(2) of the Act contains the formula for calculating the amount of the credit. This amount is determined by multiplying the appropriate percentage (17%) by $80 and by the number of months in the year during which the individual was enroled as a full-time student in a qualifying educational program at a designated educational institution. This amendment, which applies to the 1996 and subsequent taxation years, increases from $80 to $100 the monthly amount used in the formula to calculate the credit.

Clause 29

Transfer of Unused Credits to Spouse

ITA
118.8

Section 118.8 of the Act contains a formula to determine the amount of certain unused tax credits that may be transferred to an individual's spouse. These credits include the tuition fee and education tax credits, up to a maximum amount of $680, which are represented as the variable A in the formula.

This amendment modifies the description of A to increase from $680 to $850 the maximum amount of tuition fee and education tax credits that may be transferred to a spouse. In addition, the language used in the descriptions of the variables has been modified to better conform to the language currently used in the Act.

These amendments apply to the 1996 and subsequent taxation years.

Clause 30

Transfer of Unused Credits to Supporting Individuals

ITA
118.9

Section 118.9 of the Act contains a formula to determine the amount of certain unused tax credits that may be transferred to an individual's parent or grandparent. Where no tax credit is claimed by an individual's spouse in respect of the individual under section 118 of the Act or by way of a transfer of unused credits under section 118.8, the individual's parent or grandparent may deduct the individual's unused tuition fee and education tax credits, up to a maximum of $680.

This amendment to section 118.9 increases the maximum amount that may be transferred to an individual's parent or grandparent from $680 to $850. As well, the language has been modified to better conform to the language currently used in the Act.

This amendment applies to the 1996 and subsequent taxation years.

Clause 31

Deduction from Tax Payable where Employment Outside Canada

ITA
122.3(1.1)

Section 122.3 of the Act provides a tax credit to individuals resident in Canada who are employed outside Canada by a specified employer for at least six months in connection with resource, construction, installation, agricultural or engineering contracts or for the purposes of obtaining those contracts. For the purposes of this section, a "specified employer" is a person resident in Canada, a foreign affiliate of a corporation that is resident in Canada, or a partnership, where 10% or more of the interests in the partnership are owned by persons resident in Canada or corporations controlled by persons resident in Canada.

New subsection 122.3(1.1) is introduced to limit access to the tax credit where:

- an individual's employer carries on a business of providing services;

- the employer employs fewer than 6 full-time employees throughout the year in that business;

- the individual does not deal at arm's length with, or is a specified shareholder of the employer (a specified shareholder, in general, being a person that owns 10% or more of a corporation) or a member of the partnership that is the employer; and

- but for the employer's existence, the individual would be considered an employee of the person or partnership to which the services of the employer are provided.

Under these circumstances, the individual may not claim a tax credit in respect of income from that employment unless the person or partnership to which the employee's services are provided is a specified employer.

This amendment applies to the 1997 and subsequent taxation years.

Clause 32

Goods and Services tax credit

ITA
122.5

Section 122.5 of the Act provides the rules for determining the Goods and Services tax credit for individuals. As a part of that determination, reference is made, in paragraph 122.5(3)(*c*) and clause 122.5(3)(*e*)(ii)(B), to paragraphs 118(1)(*b*) and (*c*) of the Act.

These amendments to the English version of paragraph 122.5(3)(*c*) and clause 122.5(3)(*e*)(ii(B) do not change the substance of the provision. They simply modify the language used in referring to paragraphs 118(1)(*b*) and (*c*) to correctly reflect the formula used in subsection 118(1).

These amendments apply on Royal Assent.

Clause 33

Child Tax Benefit

ITA
122.61(1)

Subsection 122.61(1) of the Act contains the calculation of the child tax benefit that is available to eligible individuals in respect of qualified dependants. The benefit, which is calculated on an annual basis and paid monthly, is made up of two parts: an amount based on the number of qualified dependants of an individual and a working income supplement.

The working income supplement of the child tax benefit is equal to 8% of an individual's adjusted earned income (which includes the earned income of a spouse) in excess of $3,750, to an annual maximum supplement of $500. The supplement is reduced by 10% of the individual's adjusted income (which includes the income of a spouse) in excess of $20,921. The calculation of the working income supplement is contained in paragraph (*c*) of the description of A in subsection 122.61(1) of the Act.

These amendments to the descriptions of C and D in paragraph (*c*) of the description of A in subsection 122.61(1) implement two sets of modifications to the working income supplement.

The first set of modifications to the supplement will begin with monthly payments as of July 1997. As of that time, the annual supplement will be increased from 8% to 12% of adjusted earned income in excess of $3,750 and the maximum annual supplement increased from $500 to $750. As well, the rate at which the supplement is reduced will be changed from 10% to 15% of adjusted income over $20,291.

The second set of modifications to the supplement will begin with monthly payments as of July 1998. As of that time, the annual supplement will be further increased from 12% to 16% of adjusted earned income in excess of $3,750 and the maximum annual supplement increased from $750 to $1,000. As well, the rate at which the supplement is reduced will be changed from 15% to 20% of adjusted income over $20,291.

Clause 34

Manufacturing and Processing Profits Deductions

ITA
125.1(3)

"manufacturing or processing"

Section 125.1 of the Act provides for a reduction of federal corporate income tax where a corporation engages in manufacturing or

processing activities. The reduction for a taxation year is up to 7% of the corporation's "Canadian manufacturing and processing profits" for the year.

The definition "manufacturing or processing" in subsection 125.1(3) has been restructured so that the exclusions provided in the definition correspond with the exclusions provided in the definition of the same expression under subsection 1104(9) of the *Income Tax Regulations*.

The definition is also amended so that "Canadian field processing" as defined in subsection 248(1) of the Act is also excluded. For more detail, see the commentary on that definition below.

This amendment applies to taxation years that begin after 1996.

Clause 35

Canadian Film or Video Production Tax Credit

ITA
125.4(3)

Subsection 125.4(3) of the Act provides the Canadian film or video production tax credit. Where the conditions set out in the subsection are met in respect of a taxation year, a qualified corporation is treated as having paid an amount on account of its tax payable under Part I for the year. Such an amount is deemed to have been paid by a corporation in respect of a taxation year on the day that its remainder of taxes are payable for the year.

Subsection 125.4(3) is amended so that this day is now referred to as a corporation's "balance-due day". This amendment is strictly consequential to an amendment described below to the definition "balance-due day" in subsection 248(1) of the Act, which extends the application of the definition to corporations.

This amendment applies to the 1996 and subsequent taxation years.

Clause 36

Logging Tax Deduction

Section 127 of the Act permits deductions in computing tax payable in respect of logging taxes, political contributions and investment tax credits.

Subclauses 36(1) and (3)

ITA
127(9) and (11)

Subsection 127(5) of the Act provides for the deduction of investment tax credits from a taxpayer's Part I tax otherwise payable for a taxation year. Investment tax credits equal to 10% of the capital cost of "qualified property" are currently available where the property was acquired for use in the Atlantic provinces, the Gaspé Peninsula or the prescribed offshore region.

Under subsection 127(9), a taxpayer's "qualified property" generally includes prescribed property that is to be used in Canada primarily for the purpose of activities specified in subparagraphs (*c*)(i) to (xiii) of the definition "qualified property" in subsection 127(9). The specified activities are "manufacturing or processing", most of the activities explicitly excluded from the definition of that expression in subsection 125.1(3) of the Act and some additional activities (e.g., harvesting peat). For the purpose of subsection 127(9), the expression "manufacturing of processing" is defined in paragraph 127(11)(*a*) in largely the same way as the expression is defined under subsection 125.1(3).

The definition "qualified property" is amended so that the description of the specified activities referred to above corresponds more closely to the description of the exclusions from the definition "manufacturing or processing" in subsection 125.1(3). This amendment strictly involves reordering the existing words and making some minor language changes for clarity and for conformity with subsection 125.1(3).

The definition "qualified property" is also amended so that "Canadian field processing", as defined in subsection 248(1) of the Act, is also

one of the specified activities for investment tax credit purposes. This amendment is consequential on the exclusion of "Canadian field processing" from the definition "manufacturing or processing" in subsection 125.1(3).

Paragraph 127(11)(*a*) is amended to make cross reference changes necessary as a consequence of the revised definition "manufacturing or processing" in subsection 125.1(3).

Paragraph 127(11)(*a*) is also amended so that, for the purposes of the definition "qualified property", the characterization of an activity as "manufacturing or processing" does not depend on whether the material processed originates from outside Canada. This is of practical significance only because certain steam and energy generation equipment is "qualified property" under paragraph (*c*.1) of the definition "qualified property". Paragraph (*c*.1) of that definition, unlike paragraph (*c*) of that definition, applies only where the steam or energy is used for the purpose of "manufacturing or processing", as defined under paragraph 127(11)(*a*).

These amendments apply to taxation years that begin after 1996.

Subclause 36(2)

ITA
127(10.2)

Subsection 127(10.1) of the Act allows up to 15% of a corporation's SR&ED expenditures made in a taxation year to be added in determining the corporation's investment tax credit at the end of the year. The amount so added under subsection 127(10.1) is limited to 15% of the corporation's "expenditure limit" for the year, as determined under subsection 127(10.2).

A corporation's "expenditure limit" for a taxation year is determined by a formula in subsection 127(10.2). The maximum value determined under the formula is $2 million. However, one part of the formula reduces a corporation's expenditure limit by $10 for each $1 that the total taxable incomes of the corporation and associated corporations for specified previous taxation years is in excess of $200,000.

The description of A in subsection 127(10.2) is amended so that, for the purpose of determining a corporation's expenditure limit, taxable income for a taxation year is determined before taking into consideration "specified future tax consequences" for the year. "Specified future tax consequences" (which is described in greater detail in its new definition in subsection 248(1) of the Act) refers to adjustments arising because of the carryback of losses or similar amounts or because of corrections of certain amounts renounced in connection with the issue of flow-through shares.

This amendment applies for the purpose of computing the "expenditure limit" of a corporation for taxation years that begin after 1995. (However, there are no "specified future tax consequences" for previous taxation years referred to above unless they end after 1995.)

Clause 37

Refundable Investment Tax Credits

ITA
127.1(1) and (2)

Subsection 127.1(1) of the Act provides that a taxpayer's refundable investment tax credit for a taxation year, to the extent so designated by the taxpayer, is deemed to be paid on account of the taxpayer's tax for the year under Part I as of the date of filing the return for the year or a prescribed form amending a prior year's return.

A corporation is only permitted to have a refundable investment tax credit for a taxation year if it is a "qualifying corporation" (as defined in subsection 127.1(2)) for the year. A "qualifying corporation" for a taxation year is defined as a Canadian-controlled private corporation, where the corporation's taxable income (in combination with the taxable income of associated corporations) for specified previous taxation years does not exceed the total business limits of such corporations for those years. The business limits referred to are those determined for the purposes of the small business deduction in section 125 of the Act. (The total business limit for a corporation and its associated corporations is a maximum of $200,000, but is reduced to reflect liability for the large corporations' tax under Part I.3.)

Subsection 127.1(1) is amended to provide that the refundable tax credit is deemed to have been paid on the day that the taxpayer is required to pay the balance of estimated taxes for the year. This will allow the deemed payment to be taken into account in determining the interest on arrears of taxes payable under other Parts of the Act. This amendment applies to taxation years that end after February 22, 1994.

The definition "qualifying corporation" in subsection 127.1(2) is amended so that, for the purpose of determining a corporation's status as such, taxable income for a taxation year is determined before taking into consideration "specified future tax consequences" for the year. "Specified future tax consequences" (which is described in greater detail in its new definition in subsection 248(1) of the Act) refers to adjustments arising because of the carryback of losses or similar amounts or because of corrections of certain amounts renounced in connection with the issue of flow-through shares. This amendment applies for the purpose of determining a corporation's status as a "qualifying corporation" for taxation years that begin after 1995. (However, there are no "specified future tax consequences" for previous taxation years referred to above unless they end after 1995.)

The definition "qualifying corporation" makes references to a corporation's "business limit". It is noted that this expression is now defined in subsection 248(1) as a corporation's business limit determined under section 125 of the Act.

Clause 38

Labour-Sponsored Venture Capital Corporations

ITA
127.4

Section 127.4 of the Act provides a tax credit for individuals acquiring shares issued by labour-sponsored venture capital corporations (LSVCCs).

The existing rules generally limit an individual's tax credit for a taxation year to the lesser of

- 20% of the net cost of LSVCC share purchases in the year and in the first 60 days of the following year by the individual or an RRSP trust funded by the individual, and

- $1,000 (i.e., up to $5,000 of annual LSVCC share purchases).

Subject to transition rules for 1996, the amendments to section 127.4 provide that an individual's tax credit is limited to a uniform 15% of the total net cost (not exceeding $3,500) of eligible LSVCC share purchases, regardless of the provincial tax credit provided to the individual in respect of the LSVCC share.

The amendments to section 127.4 also provide a 3-year "cooling-off" period. A redemption of an LSVCC share in a taxation year generally results in the individual who was entitled (or who would otherwise be entitled) to claim an LSVCC tax credit in respect of the original acquisition of the redeemed share being prohibited from deducting any LSVCC tax credits under section 127.4 for the year of the redemption and the two following years.

The commentary below explains the amendments in greater detail.

Definitions

Subsection 127.4(1) defines a number of expressions used in section 127.4.

The definition "approved share" is amended for the 1996 and subsequent taxation years so that an "approved share" is simply a share of a capital stock of a labour-sponsored venture capital corporation prescribed under Part LXVII of the *Income Tax Regulations*. Other elements of the existing definition are now contained in the new definition "original acquisition", described below. These amendments are being made for technical clarity and do not reflect any change of policy to section 127.4.

The definition "labour-sponsored funds tax credit" is being repealed for the 1996 and subsequent taxation years. No definition of this expression is needed in subsection 127.4(1), in light of amended subsections 127.4(5) and (6).

The definition "original acquisition" is introduced. The new definition applies after 1995. Subject to the rules set out below, the "original acquisition" of a share is its first acquisition. However, for the purposes of this definition:

- an "original acquisition" of a share is, except as provided below, considered to arise the first time that the share is irrevocably subscribed and paid for,

- a share is considered never to have been acquired and never to have been irrevocably subscribed and paid for unless the first registered holder of the share is the first person to either acquire or irrevocably subscribe and pay for the share, and

- notwithstanding either of the above rules, a broker or dealer in securities acting in that capacity is considered never to acquire or subscribe and pay for the share and never to be the registered holder of the share.

Calculation of Tax Credit Claim under subsection 127.4(2)

- *1997 and subsequent taxation years*

Under amended subsection 127.4(2), an individual may generally deduct, from the tax otherwise payable by the individual for a taxation year, up to the individual's "labour-sponsored funds tax credit limit" for the year. However, as described in the commentary on the 3-year cooling-off period below, an exception is provided in certain cases where shares of the capital stock of an LSVCC have been redeemed, acquired or cancelled by the LSVCC.

New subsection 127.4(5) sets out the calculation of an individual's "labour-sponsored funds tax credit limit" for a taxation year. It is equal to the total of all the individual's "labour-sponsored funds tax credits" in respect of original acquisitions 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 as are total original acquisitions in excess of $3,500. (The $3,500 limit is referred to in the commentary below as the $3,500 consideration limit.)

New subsection 127.4(6) sets out the calculation of an individual's "labour-sponsored funds tax credit" in respect of an "original acquisition" of an approved share for a taxation year. Except as provided by new paragraphs 127.4(6)(*b*), (*c*) and (*d*), this tax credit is generally equal to 15% of the net cost to the individual (or to an RRSP trust funded by the individual) in respect of the original acquisition of the share by the individual or the trust.

New paragraphs 127.4(6)(*b*), (*c*) and (*d*) provide rules that eliminate an individual's tax credit with respect to the original acquisition of an LSVCC share in three exceptional cases. The first case, consistent with existing paragraph 127.4(3)(*b*), is where a required information return in respect of the share is not filed with the individual's income tax return. The second case applies where the share is acquired after the individual's death by the individual's estate or through a spousal RRSP funded by the individual or the individual's estate. The third case applies where an amount has been refunded under section 211.9 to the individual by the Minister of National Revenue in respect of a disposition of the share. For further details on section 211.9, see the commentary on new Part XII.5 of the Act.

EXAMPLE

> *Marie is issued $3,000 of approved shares by an LSVCC in January 1998.*
>
> *Results:*
>
> *1. As a consequence of the acquisition, Marie may deduct $450 ($3,000 X 15%) in computing her tax payable for the 1997 taxation year.*
>
> *2. Because Marie is acquiring only $3,000 of shares, the $3,500 consideration limit is not applicable.*

- *transitional rules for the 1996 taxation year*

The calculation of an individual's tax credit claim under subsection 127.4(2) for the 1996 taxation year is, subject to three exceptions, the same as for the 1997 taxation year. The three exceptions are as follows:

- the explicit rule with respect to acquisitions of shares after the death of an individual applies only to deaths that occur after ANNOUNCEMENT DATE,

- an individual can take into account total original acquisitions of shares (up to $5,000) before March 6, 1996 without reference to the lowering of the LSVCC tax credit rate to 15%, but original acquisitions after March 5, 1996 cannot result in the individual's labour-sponsored funds tax credit limit exceeding $525 (i.e., $3,500 X 15%), and

- the 3-year cooling-off period (described below) does not affect claims for the 1996 taxation year.

EXAMPLE

Paul acquired $6,000 of shares of the capital stock of an LSVCC in January 1996, of which $5,000 was taken into account for his 1995 taxation year. He acquired a further $2,000 of shares of the capital stock of the LSVCC in June 1996.

Results:

1. Paul may deduct $500 in computing his tax payable for his 1996 taxation year. This is equal to the sum of:

- *$200 (i.e., 20% X the amount ($1,000) which represent the cost of shares acquired before March 6, 1996 which were not taken into account in computing tax payable for Paul's 1995 taxation year), and*

- *$300 (i.e., 15% X $2,000).*

2. The $3,500 consideration limit for the 1996 taxation year does not apply, as the consideration given for shares that is taken into account for the 1995 taxation year is ignored for this purpose.

3-Year Cooling-off Period

New subsections 127.4(3) and (4) implement the 3-year cooling-off period.

It applies to an individual where a share of the capital stock of an LSVCC is redeemed, acquired or cancelled by the LSVCC and the original acquisition of the share was by the individual (or by an RRSP trust funded by the individual). Where this is the case, an individual is generally not allowed to claim any tax credit under subsection 127.4(2) for the year of such transaction and for each of two following taxation years. However, as described below, exceptions are provided in certain cases.

Under new subsection 127.4(4), an individual is not prevented from deducting an amount under subsection 127.4(2) for a taxation year because of the redemption, acquisition or cancellation of an LSVCC share where:

- the individual dies in the year and before the redemption, acquisition or cancellation;
- the individual's labour-sponsored funds tax credit in respect of the original acquisition of the share is nil;
- tax becomes payable under Part XII.5 because of the redemption, acquisition or cancellation;
- an amount determined under section 6706 of the Regulations is directed to be remitted to the Receiver General in order to permit the redemption, acquisition or cancellation; or
- the individual becomes either disabled and permanently unfit for work or terminally ill in the year after the last original acquisition in the year of any LSVCC share by the individual (or by an RRSP trust funded by the individual) and before the redemption, acquisition or cancellation.

These amendments apply in respect of redemptions, acquisitions or cancellations of LSVCC shares after March 5, 1996 (otherwise than

pursuant to a request before March 6, 1996). However, as a transitional measure, these amendments do not apply to prevent an individual from claiming a deduction under subsection 127.4(2) for the 1996 taxation year.

Clause 39

Part XII.4 Tax Credit

ITA
127.41(3)

Section 127.41 of the Act provides for the tax credit in respect of tax paid by a mining reclamation trust under Part XII.4 of the Act. The tax credit is available to a beneficiary to whom trust income has been flowed-out. The tax credit is applied, to the maximum extent possible, to reduce the beneficiary's Part I tax. To the extent that the tax credit cannot be fully applied in this manner, it is considered under subsection 127.4(3) to be paid on account of the beneficiary's tax under Part I on the day the beneficiary is required to pay the balance of the beneficiary's taxes.

Subsection 127.41(3) is amended so that this day is now referred to as a taxpayer's "balance-due day", whether the taxpayer is an individual or a corporation. This amendment is strictly consequential to an amendment described below to the definition "balance-due day" in subsection 248(1) of the Act, which extends the application of the definition to corporations.

This amendment applies to the 1996 and subsequent taxation years.

Clause 40

Insurance Corporations

ITA
138

Section 138 of the Act sets out detailed rules relating to the taxation of insurance corporations.

Subclause 40(1)

Insurer’s income or loss

ITA
138(2)

Subsection 138(2) of the Act provides that a resident life insurer’s income or loss for a year from an insurance business is its income or loss for the year from carrying on that insurance business in Canada. Resident life insurers are, therefore, not subject to Canadian tax on their foreign insurance businesses.

Subsection 138(2) is amended in three ways. First, existing paragraphs 138(2)(*a*) and (*b*) are incorporated into amended paragraph 138(2)(*a*).

Second, new paragraph 138(2)(*b*) incorporates a rule currently found in section 142 of the Act. This rule excludes from the income of a resident life insurer taxable capital gains and allowable capital losses on dispositions of property used or held in the course of carrying on an insurance business outside of Canada. Amended paragraph 138(2)(*b*) provides that taxable capital gains and allowable capital losses on dispositions of property that are not "designated insurance property" are not included in the insurer’s income where the property is used or held in the course of carrying on an insurance business. The new definition "designated insurance property" is set out in amended subsection 138(12) and the Regulations.

Finally, subsection 138(2) is amended to confirm that it applies only to life insurers resident in Canada that carry on an insurance business both in Canada and outside of Canada.

Amended subsection 138(2) applies to the 1996 and subsequent taxation years.

Subclause 40(2)

ITA
138(3)(*a*)(i)

Subparagraph 138(3)(*a*)(i) of the Act permits a life insurer to deduct in computing its income for a taxation year such amount as is allowed by regulation as a policy reserve in respect of its life insurance policies of a particular class. Subparagraph 138(3)(*a*)(i) is amended to ensure that it provides a life insurer with the authority to claim a deduction for policy reserves in an amount up to (but not exceeding) the amount allowed by regulation. It should also be noted that subparagraph 138(3)(*a*)(i) applies in respect of both "pre-1996 life insurance policies" and "post-1995 life insurance policies".

Amended subparagraph 138(3)(*a*)(i) applies to the 1996 and subsequent taxation years.

ITA
138(3)(*a*)(ii)

Subparagraph 138(3)(*a*)(ii) of the Act permits a life insurer to deduct in computing its income for a taxation year a prescribed amount as a reserve in respect of claims under life insurance policies that were received by it before the end of the year and that are unpaid at the end of the year. Subparagraph 138(3)(*a*)(ii) is amended to ensure that it provides a life insurer with the authority to claim a deduction for unpaid claims under its life insurance policies in amounts up to (but not exceeding) the amounts allowed by regulation. It should also be noted that subparagraph 138(3)(*a*)(ii) applies in respect of both "pre-1996 life insurance policies" and "post-1995 life insurance policies".

Amended subparagraph 138(3)(*a*)(ii) applies to the 1996 and subsequent taxation years.

ITA
138(3)(*a*)(ii.1)

New subparagraph 138(3)(*a*)(ii.1) of the Act will permit a life insurer to claim a deduction in respect of negative policy reserves that were included in the insurer’s income in the preceding year pursuant to

new paragraph 138(4)(*b*) of the Act and the regulations thereunder. In general terms, negative policy reserves arise where the present value of future premiums exceeds the present value of future estimated benefits and expenses in respect of the insurer's policies.

New subparagraph 138(3)(*a*)(ii.1) applies to the 1996 and subsequent taxation years.

Subclause 40(3)

ITA
138(4)

Subsection 138(4) of the Act requires a life insurer to include certain amounts in computing its income under Part I for a taxation year. Subsection 138(4) is amended to require a life insurer to include in income the amount prescribed by new subsection 1404(2) of the Regulations to be the "negative policy reserves" in respect of the insurer's life insurance policies that are post-1995 life insurance policies. In general terms, negative policy reserves arise where the present value of future premiums exceeds the present value of future estimated benefits and expenses in respect of the insurer's policies.

Amended subsection 138(4) applies to the 1996 and subsequent taxation years.

ITA
138(4.01)

New subsection 138(4.01) of the Act extends the meaning of life insurance policy, for the purposes of subsections 138(3) and (4) and the regulations made thereunder, to include benefits under, both, group life insurance policies and group annuity contracts. This extended definition of life insurance policy was previously found in section 1404 of the Regulations. New subsection 138(4.01) applies to the 1996 and subsequent taxation years.

Subclause 40(4)

Idem.

ITA
138(4.4)

Subsection 138(4.4) of the Act includes a prescribed amount in computing a life insurer’s income in respect of vacant real property or real property under development. This provision applies where the property is "property used by it in the year in, or held by it in the year in the course of" (as defined in subsection 138(12)) carrying on an insurance business in Canada. Subsection 138(4.4) is amended consequential upon the repeal of that definition and the addition of the definition "designated insurance property" to subsection 138(12).

Subsection 138(4.4) is also amended to clarify that an amount is prescribed in respect of each property referred to in paragraphs 138(4.4)(*a*) to (*d*). Corresponding amendments to the Regulations will also be made.

This amendment applies to the 1996 and subsequent taxation years.

Subclauses 40(5) and (6)

Application

ITA
138(4.5)

Subsection 138(4.5) of the Act applies where a life insurer transfers or lends real property described in subsection 138(4.4) to a designated corporation or a non-arm’s length person or partnership. To prevent a life insurer from avoiding the effects of subsection 138(4.4), subsection 138(4.5) requires an insurer to include an amount in the insurer’s income as if the insurer still owned the property which was transferred and subsection 138(4.4) applied with respect to that property.

Subsection 138(4.5) is amended in several ways. First, the reference to the term "designated corporation" is removed since that term has been repealed.

Second, the list of transferees which cause the provision to apply is expanded to include persons who are affiliated (as determined under section 251.1 of the Act) with the insurer.

Third, paragraph 138(4.5)(*d*) is amended to clarify that the property which is considered to be property of the insurer is treated as if it were factually used or held by the insurer in the year in the course of carrying on an insurance business in Canada and, therefore, subject to subsection 138(4.4) of the Act.

This amendment applies to the 1996 and subsequent taxation years.

Subclause 40(7)

Deductions not allowed

ITA
138(5)(*b*)

Subparagraphs 138(5)(*b*)(i) and (ii) of the Act restrict a non-resident insurer's and a resident multinational life insurer's interest deduction under paragraph 20(1)(*c*) and (*d*) of the Act. Interest is only deductible in respect of amounts used to acquire property that is designated by the insurer as "property used by it in the year in, or held by it in the year in the course of" (as defined in subsection 138(12) of the Act) carrying on an insurance business in Canada.

As a consequence of the repeal of the definition of "property used by it in the year in, or held by it in the year in the course of" carrying on an insurance business, subparagraphs 138(5)(*b*)(i) and (ii) are amended to replace the reference to that definition with a reference to the new definition "designated insurance property" (which is discussed below in the comments on subsection 138(12).

New subparagraph 138(5)(*b*)(iv) is added to the Act to allow resident multinational life insurers and non-resident insurers to deduct interest (other than interest already described in subparagraphs 138(5)(i) to (iii)) that does not exceed a prescribed amount.

This amendment applies to the 1996 and subsequent taxation years.

Subclause 40(8)

Amounts paid to shareholders

ITA
138(7)

Subsection 138(7) of the Act requires a stock life insurer to include additional amounts in income in respect of dividends paid to its shareholders. This provision, which is designed to tax profits accumulated before 1969, and certain foreign branch profits, when these profits are distributed to shareholders, is repealed for the 1996 and subsequent taxation years.

Subclause 40(9)

Computation of income

ITA
138(9)

Subsection 138(9) of the Act and its related provisions set out the rules for determining the investment income of non-resident insurers and resident life insurers that carry on an insurance business both inside and outside of Canada.

Under paragraph 138(9)(*a*) an insurer must include in its income from carrying on its insurance businesses in Canada its gross investment revenue from its "property used by it in the year in, or held by it in the year in the course of" (as defined in subsection 138(12)) carrying on those insurance businesses in Canada. Gross investment revenue includes amounts such as taxable dividends, interest, rents and royalties. Part XXIV of the Regulations contains special rules for determining what property is considered to be "property used by it in the year in, or held by it in the year in the course of" carrying on an insurance business.

In general, Part XXIV of the Regulations requires an insurer to compute an amount called a "Canadian investment fund for the year" which represents the value of the insurer’s investment property that is considered to be used or held in support of its Canadian insurance businesses. The insurer then chooses – a process referred to as the

designation of property – from all its property, property with a value equal to its Canadian investment fund for the year. That property is considered to be "property used by it in the year in, or held by it in the year in the course of" carrying on an insurance business in Canada.

Paragraph 138(9)(*a*) is amended consequential on the replacement of the definition of "property used by it in the year in, or held by it in the year in the course of" in subsection 138(12) with the definition of "designated insurance property".

Paragraph 138(9)(*b*), which is not substantively amended, requires an insurer to include in its income from carrying on its insurance businesses in Canada an amount, if any, determined in respect of the insurer under section 2411 of the Regulations. Regulation 2411 requires that a minimum amount of net investment revenue be included in an insurer's Canadian income.

This amendment applies to the 1996 and subsequent taxation years.

Application of financial institution rules

ITA
138(10)

Subsection 138(10) of the Act provides that the financial institution rules in sections 142.2 to 142.5 of the Act apply to property owned by a resident multinational life insurer or a non-resident insurer where it is "property used by it in the year in, or held by it in the year in the course of" (as defined in subsection 138(12)) carrying on an insurance business in Canada. Subsection 138(10) is amended consequential on the replacement of the definition of "property used by it in the year in, or held by it in the year in the course of" in subsection 138(12) with the definition of "designated insurance property". Part XXIV of the Regulations contains the rules for determining what property is designated insurance property of an insurer.

The subsection is also amended to clarify that sections 142.2 to 142.5 apply to a resident multinational life insurer or non-resident insurer only when the property is designated insurance property of the insurer. If the property is not designated, those rules do not apply.

This amendment applies to the 1996 and subsequent taxation years.

Identical properties

ITA
138(11.1)

Subsection 138(11.1) of the Act applies for the purposes of the application of the identical property rules in section 47 of the Act. The subsection provides that property owned by a life insurance corporation can only be considered to be identical to other property owned by it if both properties are "property used by it in the year in, or held by it in the year in the course of" (as defined in subsection 138(12)) carrying on the same insurance business.

Subsection 138(11.1) is amended consequential on the replacement of the definition of "property used by it in the year in, or held by it in the year in the course of" in subsection 138(12) with the definition of "designated insurance property". Part XXIV of the Regulations contains the rules for determining what property is designated insurance property of an insurer.

This amendment applies to the 1996 and subsequent taxation years.

Subclause 40(10)

Deemed disposition

ITA
138(11.3) and (11.31)

Except for certain limited purposes, subsection 138(11.3) of the Act provides for a deemed disposition and reacquisition of property owned by a resident multinational life insurer or a non-resident insurer where there is a change in use of the property. In this context, a change in use occurs when property of an insurer that is "property used by it in the year, or held by it in the year in the course of", as defined in subsection 138(12), carrying on an insurance business in Canada is converted to some other use, or vice versa. Part XXIV of the Regulations contains the rules for determining what property is considered to be so used or held in carrying on an insurance business. Subsection 138(11.3) is amended consequential on the replacement of

the definition of "property used by it in the year in, or held by it in the year in the course of" in subsection 138(12) with the definition of "designated insurance property".

Subsection 138(11.3) is also amended to provide that any deemed disposition or reacquisition is considered to have occurred at the beginning of the year in which the property is no longer designated insurance property or becomes designated insurance property, as the case may be. This reflects the fact that property is either designated insurance property for the year or not designated insurance property for the year.

Subsection 138(11.31) provides that subsection 138(11.3) does not apply to a change in use of property where the mark-to-market requirement in subsection 142.5(2) of the Act deems the property to have been disposed of at the end of the taxation year ending immediately before the change in use.

Subsection 138(11.31) is amended in two respects. New paragraph 138(11.31)(*a*) contains the existing mark-to-market rule which is consequentially amended to reflect the amendments to subsection 138(11.3). New paragraph 138(11.31)(*b*) contains the exceptions to the application of subsection 138(11.3) which were contained in the preamble of that subsection.

These amendments apply to the 1996 and subsequent taxation years.

Subclause 40(11)

Transfer of insurance business by non-resident insurer

ITA
138(11.5)

Subsection 138(11.5) of the Act sets out the rules which allow a non-resident insurer to transfer, on a tax-deferred basis, an insurance business carried on in Canada through a branch to a qualified related corporation. Paragraph 138(11.5)(*h*) provides that the non-resident transferor and the corporate transferee are deemed to have taxation years ending immediately before the transferor ceases to carry on the business which is being transferred. Paragraph 138(11.5)(*i*) provides that for the purposes of computing the transferor's gross investment

revenue and gains and losses for taxation years following the taxation year that ended because of paragraph 138(11.5)(*h*), the business, its assets and liabilities are considered to have been transferred on the last day of that taxation year. Paragraph 138(11.5)(*i*) ensures that the gross investment revenue and gains and losses from the transferred business are not included in the transferor's income after the business is transferred.

Paragraph 138(11.5)(*i*) is amended as a consequence of the replacement of the definition of "property used by it in the year in, or held by it in the year in the course of" in subsection 138(12) with the definition of "designated insurance property". Part XXIV of the Regulations contains the rules for determining what property is designated insurance property of an insurer.

This amendment applies to the transfer by an insurer of an insurance business in its 1996 or a subsequent taxation year.

Subclause 40(12)

ITA
138(11.5)(*j*.1)

Subsection 138(11.5) of the Act provides rules which allow a non-resident insurer (the "transferor") to transfer, on a tax-deferred basis, an insurance business carried on in Canada to a qualified related corporation (the "transferee") within the meaning assigned by subsection 219(8) of the Act. Paragraph 138(11.5)(*j*) provides that insurance reserves claimed by the transferor are deemed to have been deducted by the transferee for the taxation years deemed by paragraph 138(11.5)(*h*) to have ended before the transfer. Consequently, the transferee must include such amounts in computing its income for the following year. Similarly, new paragraph 138(11.5)(*j*.1) provides that negative policy reserves included in the transferor's income under new paragraphs 12(1)(*e*.1) and 138(4)(*b*) for the taxation year deemed to have ended before the transfer are deemed to have been included in the transferee's income for such year. This will enable the transferee to claim a deduction for such amounts in the following year pursuant to new subsection 20(22) or new subparagraph 138(3)(*a*)(ii.1).

New paragraph 138(11.5)(*j*.1) applies to the 1996 and subsequent taxation years.

Subclause 40(13)

Computation of income of non-resident insurer

ITA
138(11.91)(*d*)

Subsection 138(11.91) of the Act provides rules for the computation of a non-resident insurer's income where the insurer commences to carry on an insurance business in Canada or ceases to be exempt from tax under Part I of the Act. Paragraph 138(11.91)(*c*) provides that the insurer is deemed to have had a taxation year ending immediately before the year during which the insurer commenced business in Canada or ceased to be exempt from tax.
Paragraph 138(11.91)(*d*) treats the insurer as have maximized its reserves for the preceding taxation year under section 33 and paragraph 138(3)(*c*) of the Income Tax Act, 1952, and paragraphs 20(1)(*l*) and (*l*.1), 20(7)(*c*), subparagraphs 138(3)(*a*)(i), (ii) and (iv), of the Act.

Paragraph 138(11.91)(*d*) is amended as a consequence of the replacement of the definition of "property used by it in the year in, or held by it in the year in the course of" in subsection 138(12) with the definition of "designated insurance property". Part XXIV of the Regulations contains the rules for determining what property is designated insurance property of an insurer.

Paragraph 138(11.91)(*d*) is also amended by removing the references to the reserves in section 33 (the money lending reserve) and paragraph 138(3)(*c*) (the investment reserve) of the Income Tax Act, 1952 since those provisions have been repealed.

These amendments apply to the 1996 and subsequent taxation years.

ITA
138(11.91)(*d*.1)

Subsection 138(11.91) of the Act provides rules for the purpose of computing the income of a non-resident insurer that commences to

carry on a business in Canada or that ceases to be exempt from tax under Part I in a particular taxation year. Paragraph 138(11.91)(*d*) treats the insurer as having claimed the maximum insurance reserves for the year deemed by paragraph 138(11.91)(*c*) to have ended immediately before the beginning of the particular taxation year. Accordingly, the non-resident insurer must include such amounts in computing its income in Canada for the following year. Similarly, new paragraph 138(11.91)(*d*.1) deems the non-resident insurer to have carried on business in Canada in the year deemed to have ended immediately before the beginning of the particular taxation year and to have included in income the amount of negative policy reserves that would have been prescribed in respect of the insurer for the purposes of new paragraphs 12(1)(*e*.1) and 138(4)(*b*) and the regulations thereunder. This will enable the non-resident insurer to claim a deduction for such amounts in the particular year pursuant to new subsection 20(22) or new subparagraph 138(3)(*a*)(ii.1).

New paragraph 138(11.91)(*d*.1) applies to the 1996 and subsequent taxation years.

Subclause 40(14)

Computation of income where insurance business is transferred

ITA
138(11.92)(*c*)

Subsection 138(11.92) of the Act provides rules which apply where an insurer has disposed of all or substantially all of either an insurance business or a line of an insurance business carried on in Canada and the purchaser has assumed the obligations of the business. For the purposes of computing the parties' gross investment revenue and gains and losses from property, under paragraph 138(11.92)(*c*) the insurer and the purchaser are deemed to have a taxation year-end immediately before the disposition of the business and to have transferred the insurance business on the last day of that year.

Paragraph 138(11.92)(*c*) is amended as a consequence of the replacement of the definition of "property used by it in the year in, or held by it in the year in the course of" in subsection 138(12) with the definition of "designated insurance property". Part XXIV of the

Regulations contains the rules for determining what property is designated insurance property of an insurer.

This amendment applies to the disposition by an insurer of an insurance business or a line of an insurance business in its 1996 or a subsequent taxation year.

Subclause 40(15)

Transfer of an insurance business by resident insurer

ITA
138(11.94)(*b*)

Subsection 138(11.94) of the Act provides rules which apply to the transfer of an insurance business carried on in Canada by an insurer resident in Canada to a resident subsidiary on a tax-deferred basis. Under paragraph 138(11.94)(*b*) the transferor insurer must transfer all or substantially all of its "property used by it in the year in, or held by it in the year in the course of", as defined in subsection 138(12), carrying on the insurance business being transferred. Property considered to be so used or held is determined in accordance with rules in Part XXIV of the Regulations.

Paragraph 138(11.94)(*b*) is amended by changing the reference to "property used by it in the year in, or held by it in the year in the course of" with a reference to property that is factually used or held by the insurer in the course of carrying on the insurance business.

This amendment applies to the 1996 and subsequent taxation years.

Subclauses 40(16) and (17)

Definitions

ITA
138(12)

Subsection 138(12) of the Act contains definitions which are relevant for the purposes of computing an insurer’s income from carrying on an insurance business in Canada. Three definitions in subsection 138(12) are amended.

The definition of "accumulated 1968 deficit" is moved from subsection 138(12) of the Act to subsection 219(7) of the Act because it is no longer relevant for the purposes of Part I of the Act, but is still used in Part XIV of the Act.

The definition of "relevant authority" is no longer used and is repealed.

The definition of "property used by it in the year in, or held by it in the year in the course of" carrying on an insurance business is repealed and replaced with the definition of "designated insurance property". The new definition provides that the old definition is still applicable to the 1995 taxation year and taxation years preceding 1995.

These amendments apply to the 1996 and subsequent taxation years.

Clause 41

Taxable Capital Gains

ITA
142

Section 142 of the Act provides special rules for determining a resident multinational life insurer's taxable capital gains and allowable capital losses. The section provides that such insurers do not include any taxable capital gains or allowable capital losses from dispositions of property that are used or held in the course of carrying on an insurance business outside of Canada. This is an exception to the normal rule which requires residents of Canada to calculate their income on a worldwide basis. Section 142.1 of the Act provides that the definitions in subsection 138(12) of the Act apply for the purposes of section 142.

Because amended paragraph 138(2)(*b*) of the Act incorporates the rules in sections 142, that section and section 142.1 are repealed.

These amendments apply to the 1996 and subsequent taxation years.

Clause 42

Registered Retirement Savings Plans

ITA
146

Section 146 of the Act provides rules relating to registered retirement savings plans (RRSPs).

Subclauses 42(1) and (2)

ITA
146(1)

"unused RRSP deduction room"

The definition "unused RRSP deduction room" in subsection 146(1) of the Act measures the amount of an individual's unused RRSP deduction room that can be carried forward to be used by the individual in subsequent years.

In general terms, an individual's unused RRSP deduction room at the end of a year is the amount of new RRSP deduction room that has become available, less the amount of RRSP deductions claimed, since 1991. However, the amount of unused room carried forward is subject to a limit based on the individual's earned income for the previous seven years. This limit was first scheduled to have an impact in determining unused room carried forward from 1998 to 1999.

The definition "unused RRSP deduction room" is amended to remove this limit. As a result, unused room accumulating since 1991 can be carried forward indefinitely.

This amendment is effective on Royal Assent.

Subclause 42(3)

ITA
146(2)(*b*.4)

Subsection 146(2) of the Act sets a number of requirements that must be satisfied in order for a retirement savings plan to qualify for registration. Paragraph 146(2)(*b*.4) requires that a retirement savings plan must not provide for maturity after the year in which the annuitant turns 71 years of age.

Paragraph 146(2)(*b*.4) is amended to require that a retirement savings plan not provide for maturity after the year in which the annuitant turns 69 years of age.

This amendment applies after 1996, with the following qualifications.

- It does not apply to a retirement savings plan where the annuitant under the plan turned 70 years of age before 1997.

- Where the annuitant under a retirement savings plan turns 70 years of age in 1997, it is modified to require that the plan not provide for maturity after that year.

- It does not apply to a retirement savings plan that was registered before 1997. This means that the terms of such a plan do not have to reflect the earlier maturity date, even if the plan is amended after 1996. However, if the plan does not mature by the time it would have had to mature if amended paragraph 146(2)(*b*.4) had applied, it will lose its registered status immediately thereafter by virtue of new subsection 146(13.2) and existing subsection 146(12) (see the commentary under subsection 146(13.2) for further details).

Subclause 42(4)

ITA
146(13.2)

New subsection 146(13.2) of the Act provides a mechanism whereby an RRSP that was registered before 1997 becomes deregistered if it does not mature by the end of the year in which the annuitant turns

69 years of age. In such a case, subsection 146(13.2) deems the plan to have become, at the beginning of the following year, an amended plan which does not comply with the RRSP registration requirements. In accordance with existing subsection 146(12), the plan thus loses its registered status at that time and the fair market value of the property of the plan is included in the annuitant's income.

New subsection 146(13.2) applies after 1996, with the following qualifications.

- It does not apply to an RRSP where the annuitant under the plan turned 70 years of age before 1997.

- Where the annuitant under an RRSP turns 70 years of age in 1997, it is modified so that it applies only if the plan does not mature by the end of that year.

- It does not apply to an RRSP where an annuity contract was acquired before March 6, 1996 to provide the retirement income under the plan. This exception applies only if the contract, as it read on March 5, 1996, satisfied certain conditions. First, it must have provided for the annuity to commence on a specific date and the date must be after the year in which the annuitant turns 69 (70 if the annuitant turned 69 in 1996). Second, it must have established the amount and timing of each annuity payment. This exception is intended to ensure that such a contract does not have to be renegotiated in order to avoid deregistration of the RRSP.

- It does not apply to an RRSP that is part of a life insurance policy that was issued before March 6, 1996. This exception applies only if the contract, as it read on March 5, 1996, satisfied certain conditions. First, it must have provided for life insurance coverage after the year in which the annuitant turns 69 (70 if the annuitant turned 69 in 1996). Second, it must have established the amount of life insurance payable under the policy and the amount of premiums required to keep the policy in force. This exception is intended to ensure that the annuitant under such an RRSP is not required to forfeit life insurance coverage that would otherwise have been provided under the policy after the earlier maturity date and before the end of the year in which the annuitant turns 71 in order to avoid deregistration of the RRSP. This relief is provided in recognition of the fact that such an annuitant may not be able to

replace the forfeited insurance either because he or she is no longer insurable or because the cost of replacement insurance is prohibitive.

A special coming-into-force provision is introduced to deal with unscheduled increases after March 5, 1996 in premiums payable under a life insurance policy where the RRSP portion of the policy is excluded from the application of subsection 146(13.2) as noted above. The provision deems the increased portion of such a premium not to have been paid for purposes of subsections 146(5) and (5.1) (which allow deductions in respect of RRSP contributions) and for purposes of subsection 146(8.2) (which allows a deduction to offset an income inclusion resulting from the withdrawal of certain excess RRSP contributions).

This special provision has significance in applying the "split premium formula" approved by Revenue Canada for determining the portion of a life insurance policy premium that is considered to be an RRSP contribution. It means that, for each premium paid after an unscheduled increase, the formula must be applied to two separate amounts. For purposes of subsections 146(5), (5.1) and (8.2), it must be applied to the originally scheduled premium amount. For all other purposes, such as the taxation of benefits under subsection 146(8) and the application of the penalty tax provisions under Part X.1, it must be applied to the actual amount of the premium paid.

EXAMPLE

The annual policy premium established before March 6, 1996 under a grandfathered life insurance RRSP is $1,000. In applying the split premium formula approved by Revenue Canada, it is determined that 40% of each premium is considered to be an RRSP contribution.

After March 5, 1996, there is an unscheduled increase in the policy premium to $1,500. For the purposes of subsections 146(5), (5.1) and (8.2), the RRSP portion of each premium is $400 (40% of $1,000) while, for all other purposes, the RRSP portion is $600 (40% of $1,500). Thus, only $400 of each premium is eligible for deduction, but $600 is taken into account for penalty tax purposes.

Furthermore, while the full $600 is subject to tax when paid out of the RRSP, no offsetting deduction in respect of the previously undeducted excess of $200 can be claimed under subsection 146(8.2).

ITA
146(13.3)

New subsection 146(13.3) of the Act requires that, where an RRSP may become deregistered by virtue of new subsection 146(13.2) and existing subsection 146(12), the issuer of the RRSP must provide written notification to the annuitant of this fact. This notice must be provided before July of the latest year in which the RRSP must mature in order to avoid deregistration. This means, for example, that RRSP annuitants turning 68 or 69 years of age in 1996 must be notified by the end of June 1997. Where such notification is not provided to an annuitant, the issuer is liable to a penalty under subsection 162(7) equal to the greater of $100 and $25 per day of default to a maximum of 100 days ($2,500).

Clause 43

Registered Education Savings Plan

ITA
146.1

Section 146.1 of the Act contains the provisions that deal with registered education savings plans (RESPs).

Subclause 43(1)

ITA
146.1(1)

Subsection 146.1(1) of the Act defines a number of terms that apply to RESPs.

The definition "qualifying educational program" in subsection 146.1(1) imports the definition of that term that is found in subsection 118.6(1) of the Act. This definition requires, among

other things, that a program be of not less than 3 consecutive weeks duration and that each student taking the program spend at least 10 hours per week on courses or work in the program. As well, the definition "qualifying educational program" in subsection 118.1(6) provides, in paragraph (*a*), that if a student receives certain benefits, allowances, grants or reimbursements in respect of a particular program, that program will not be considered to be a "qualifying educational program".

The definition "qualifying educational program" in subsection 146.1(1) of the Act is being amended so that the condition that a student not receive certain benefits, allowances, grants or reimbursements, which is contained in paragraph (*a*) of that definition in subsection 118.6, does not apply. As a result, for purposes of the RESP rules in section 146.1, payments may be made out of a RESP to a student, even where the student is in receipt of other benefits.

This amendment applies to the 1996 and subsequent taxation years.

Subclause 43(2)

ITA
146.1(2)

Subsection 146.1(2) of the Act contains a number of conditions that must be met in order for a education savings plan to be accepted for registration.

Paragraph 146.1(2)(*k*) ensures that a RESP will not accept payments in respect of a beneficiary which exceed $1,500 per year. This amendment to paragraph 146.1(2)(*k*), which applies to the 1996 and subsequent taxation years, raises this annual limit to $2,000.

Clause 44

Deferred Profit Sharing Plans

ITA
147

Section 147 of the Act contains rules relating to deferred profit sharing plans (DPSPs).

Subclause 44(1)

ITA
147(1)

"licensed annuities provider"

Subsection 147(1) of the Act is amended to include a definition of "licensed annuities provider". A licensed annuities provider is defined to be a person licensed or otherwise authorized under the laws of Canada or a province to carry on an annuities business in Canada.

This definition, which applies after 1991, is added for clarity and does not represent a change in policy.

Subclause 44(2)

ITA
147(1.1)

New subsection 147(1.1) of the Act provides that an employer is considered to participate in a profit sharing plan where the employer contributes or has contributed to the plan for the benefit of employees or former employees.

This amendment, which applies from January 1, 1989, is added for clarity and does not represent a change in policy.

Subclause 44(3)

ITA
147(2)(*k*)

Paragraph 147(2)(*k*) of the Act provides that, in order to qualify for registration as a DPSP, a profit sharing plan must provide for amounts vested in an employee to become payable no later than 90 days after the earliest of several times, which include the day on which the employee turns 71 years of age and the day on which the employee ceases to be employed by a participating employer. However, a DPSP may allow an employee to elect to have such amounts paid in equal instalments over a limited number of years or used to purchase an annuity for the employee commencing no later than the employee's 71st birthday.

Paragraph 147(2)(*k*) is amended to require that a DPSP provide for vested amounts to become payable no later than the end of the year in which an employee turns 69 (rather than 90 days after the employee turns 71). It is also amended so that any annuity, the purchase of which is provided for by the terms of a DPSP, is required to commence by the end of the year in which the employee turns 69. Finally, it is amended to require that a DPSP provide for amounts to become payable on termination of employment with a participating employer only if, at that time, the employee is not employed by any another employer participating in the plan.

The amendments to paragraph 147(2)(*k*) are modified with respect to employees who turn 70 years of age before 1998. For those who turn 70 in 1997, the deadline as of which vested amounts and annuities must become payable is extended to the end of 1997. For those who turned 70 before 1997, the deadlines are those that would have applied had paragraph 147(2)(*k*) not been amended.

These amendments apply after 1996. This means that no new profit sharing plans can be registered after 1996, unless the terms of the plan comply with amended paragraph 147(2)(*k*). It also means that any existing DPSPs that do not comply as of January 1, 1997 become revocable by virtue of paragraphs 147(14)(*c*.2) and (*h*). (Reference should also be made to new subsection 147(10.6) which deals with DPSP annuities purchased before 1997.)

Subclause 44(4)

ITA
147(2)(*k*.1)

Paragraph 147(2)(*k*.1) of the Act provides that, in order to qualify for registration as a DPSP, a profit sharing plan must contain a requirement that no benefit or loan which is dependent on the existence of the plan may be conferred on a beneficiary or person with whom the beneficiary does not deal at arm's length. However, subparagraph 147(2)(*k*.1)(ii) exempts from this condition amounts referred to in paragraphs 147(10)(*a*) and (*b*), which in turn refer to amounts received by a beneficiary from a DPSP and determined under any of subsections 147(10.1), (11) or (12), and amounts paid out of a DPSP to purchase an annuity for a beneficiary as permitted under subparagraph 147(2)(*k*)(vi).

Paragraph 147(2)(*k*.1) is amended so that the only amounts exempted by virtue of subparagraph (ii) are those described in subsections 147(10.1), (11) and (12). New subparagraph 147(2)(*k*.1)(ii.1) is added to continue the exemption for amounts paid out of a DPSP to purchase an annuity.

The amendments to paragraph 147(2)(*k*.1), which apply after 1991, are strictly consequential to amendments to subsection 147(10).

Subclause 44(5)

ITA
147(10)

Subsection 147(10) of the Act requires that a DPSP beneficiary include in income for a taxation year the total of all amounts received out of the plan by the beneficiary in that year. However, this total is reduced by amounts determined under subsections 147(10.1), (11) or (12) and by amounts paid out of the plan to purchase an annuity for the beneficiary as permitted under subparagraph 147(2)(*k*)(vi).

Subsection 147(10) is amended so that an amount paid to purchase an annuity does not reduce the amount that is included in the beneficiary's income under that subsection. Since the amount is not

received by the beneficiary, the purchase of the annuity is meant to be entirely disregarded for the purpose of computing the beneficiary's income.

This amendment applies to the 1992 and subsequent taxation years.

Subclause 44(6)

ITA
147(10.6)

New subsection 147(10.6) of the Act contains rules relating to annuities purchased for a DPSP beneficiary before 1997, which apply in the event that payment of the annuity does not begin by the end of the year in which the beneficiary turns 69 years of age. In such a case, the beneficiary is deemed to have disposed of the annuity immediately after the year for an amount equal to the fair market value of the annuity determined at the end of the year. By virtue of amended paragraph 56(1)(*d*.2), the beneficiary is required to include this amount in income. This parallels the treatment of registered retirement savings plans under new subsection 146(13.2).

Subsection 147(10.6) also deems the beneficiary to have acquired the annuity as a separate and newly-issued contract immediately after the year at a cost equal to its fair market value at the end of the year and it deems the contract not to have been issued pursuant to or under a deferred profit sharing plan. As a result, the contract ceases to be a prescribed annuity contract under subsection 304(1) of the Regulations and it becomes subject to the accrual rules in section 12.2 of the Act.

New subsection 147(10.6) applies after 1996, with the following qualifications.

- It does not apply to an annuity where the beneficiary attained 70 years of age before 1997.

- Where a beneficiary turns 70 years of age in 1997, it is modified so that it applies only if an annuity purchased for the beneficiary does not commence by the end of that year.

- It does not apply to an annuity that was purchased before March 6, 1996 if the annuity contract, as it read on March 5, 1996, satisfied certain conditions. First, it must have provided for payment of the annuity to commence on a specific date and the date must be after the year in which the beneficiary turns 69 (70 if the beneficiary turned 69 in 1996). Second, it must have established the amount and timing of each annuity payment. This exception is intended to ensure that such a contract does not have to be renegotiated in order to avoid the application of subsection 147(10.6).

Clause 45

Registered Pension Plans

ITA
147.1(1)

"money purchase limit"

Subsection 147.1(1) of the Act defines "money purchase limit". The definition is relevant for a number of provisions in the Act and the Regulations relating to deferred income plans. For example, a registered pension plan becomes revocable if a member's pension adjustment for a year exceeds the money purchase limit for the year. The money purchase limit also provides the basis for the limits on deductible contributions to registered retirement savings plans, contributions to deferred profit sharing plans and pensions payable under defined benefit provisions of registered pension plans.

The definition is amended so that the money purchase limit is frozen at the 1996 level of $13,500 until 2002. The limit will increase to $14,500 for 2003, $15,500 for 2004 and, for 2005 and subsequent years, it will be $15,500, subject to an adjustment to reflect increases in the average wage after 2004.

This amendment applies after 1996.

Clause 46

Definitions

ITA
148

"relevant authority"

Subsection 148(9) of the Act contains a number of definitions for the purpose of calculating a taxpayer's income in respect of certain life insurance policies. The definition of "relevant authority" was used in respect of subsection 148(5), a rule for computing a foreign tax credit in respect of allocations from a segregated fund. Since subsection 148(5) has been repealed, the definition of "relevant authority" is repealed.

This amendment applies on Royal Assent.

Clause 47

Miscellaneous Exemptions

ITA
149

Section 149 exempts certain taxpayers from tax under Part I and provides special rules relating to such taxpayers.

Subclause 47(1)

ITA
149(1)(*t*)

Paragraph 149(1)(*t*) of the Act provides a tax exemption in respect of the taxable income of an insurer for a period in which the insurer was engaged solely in the business of insurance, and in which not less than 25% of the gross premium income (net of reinsurance ceded) earned by the insurer and certain other insurers that are grouped for this purpose was from the insurance of residences of farmers and fishermen, farm property and property used in fishing ("farm risks").

Paragraph 149(1)(*t*) is amended, applicable to the 1996 and subsequent years, to expand the exemption to include insurers in respect of which not less than 20% of such premium income is from the insurance of farm risks. The extent of the exemption is described in the commentary on subsection 149(4.1). This expansion is to provide some transitional relief for insurers that fall below the current 25% threshold, but remain above the new 20% threshold.
Paragraph 149(1)(*t*) is also amended to clarify that property must be used in the business of farming or fishing in order for the premium income arising from the insurance of such property to be counted towards the 20% threshold.

Subclause 47(2)

ITA
149(4.1)

Subsection 149(4.1) of the Act limits the tax exemption provided under paragraph 149(1)(*t*). More specifically, the exemption is limited to that portion of the insurer's taxable income for a taxation year that the insurer's gross premium income (net of reinsurance ceded) earned for the year from the insurance of residences of farmers and fishermen, farm property and property used in fishing is of its total gross premium income (net of reinsurance ceded) for the year.

Subsection 149(4.1) is amended as a consequence of the expansion of the exemption under paragraph 149(1)(*t*) to include certain insurers where not less than 20% of their gross premium income (net of reinsurance ceded) is from the insurance of residences of farmers and fishermen or property used in farming or fishing businesses ("farm risks"). New subsection 149(4.1) effectively provides that where between 20 and 25 per cent of the total gross premium income (net of reinsurance ceded) of the insurer and certain other insurers that are grouped for this purpose is from the insurance of farm risks, one-half of the insurer's taxable income attributable to premium income arising from such risks is eligible for the exemption under paragraph 149(1)(*t*). The scope of the exemption is otherwise unchanged.

New subsection 149(4.1) applies to the 1996 and subsequent taxation years.

Subclause 47(3)

ITA
149(4.2)

Subsection 149(4.2) of the Act effectively provides that an insurer described by paragraph 149(1)(*t*) is exempt from tax under Part I on all of the insurer's taxable income for a taxation year and not just the portion of such income that would otherwise be determined under subsection 149(4.1), if more than 90% of the total of the gross premium income (net of reinsurance ceded) earned by it in the year and by certain other insurers that are grouped for this purpose is from the insurance of residences of farmers or fishermen, farm property or property used in fishing. The amendments to subsection 149(4.2) are strictly consequential on the amendments to paragraph 149(1)(*t*) and subsection 149(4.1) which clarify that property must be used in farming or fishing businesses in order for the premium income arising from the insurance of such property to be eligible for the Part I tax exemption.

Amended subsection 149(4.2) applies to the 1996 and subsequent taxation years.

Clause 48

Instalment Payments – "net tax owing"

ITA
156.1(1) to (1.2)

Subsection 156.1(1) of the Act sets out definitions that are relevant in determining whether an individual is exempt from paying instalments of Part I tax for a taxation year. Under the existing rules, an exemption for an individual is generally provided for a taxation year if "net tax owing" for the year, or for each of the two preceding years, is less than or equal to $2,000 ($1,200 for Quebec residents).

"Net tax owing" for a taxation year is, in general terms, the amount by which an individual's combined federal and provincial (other than Quebec) income taxes exceeds amounts withheld at source in respect of those taxes. Because of the description of D in the definition "net

tax owing", the Quebec tax abatement provided under subsection 120(2) of the Act is deducted in computing "net tax owing". The postamble to the definition "net tax owing" in subsection 156.1(1) provides that income taxes payable are, for the purposes of the definition, computed after deducting all tax credits (other than specified tax credits) and before taking into consideration loss carrybacks and other amounts referred to in subparagraphs 161(7)(*a*)(ii) to (v) of the Act.

The postamble referred to above is repealed and replaced by new subsections 156.1(1.1) and (1.2).

New subsection 156.1(1.1) provides that, for the purposes of determining the values A and B in the definition "net tax owing", income taxes payable for a taxation year are computed after deducting all tax credits (other than the specified tax credits and the Quebec tax abatement) and before taking into consideration the consequences of

- any reduction under subsection 66(12.73) of the Act of an amount purported to be renounced on a flow-through share after the beginning of the year under subsection 66(12.6) or (12.601) because of the application of subsection 66(12.66), and

- the deduction of exclusion of all amounts referred to in paragraph 161(7)(*a*).

The consequences described above are referred to as "specified future tax consequences", an expression which is now defined in subsection 248(1) of the Act. For further detail, see the commentary on the new definition.

Under new subsection 156.1(1.2), the Quebec tax abatement is generally calculated using the same assumptions for the purposes of determining the value A in the definition "net tax owing". However, because this abatement is calculated as a percentage of actual federal income tax payable for the year, the value determined for D is computed without regard to tax credits delivered in the form of deemed payments on account of tax.

This amendment applies to amounts that become payable after 1995.

Clause 49

Instalment Payments – Corporations

ITA
157

Section 157 of the Act sets out dates on or before which a corporation is required to pay amounts on account of its taxes payable under Parts I, I.3, VI and VI.1.

Under existing paragraph 157(1)(*b*)(i), the date on which the remainder of such taxes is payable is one month later than it would otherwise be for certain Canadian-controlled private corporations whose taxable income (in combination with taxable income of associated corporations) for specified taxation years does not exceed a specified limit (which is generally $200,000).

Under existing subsection 157(2), an exemption from tax instalments for a taxation year is provided to certain cooperative corporations and credit unions. This exemption applies to such an entity for a taxation year where, for the year or the preceding year, its taxable income does not exceed $10,000 and it has no tax payable under any of Parts I.3, VI and VI.1.

Under existing subsection 157(2.1), a more general exemption from tax instalments for a taxation year is provided to corporations. The exemption applies where the total taxes payable for the year under Parts I, I.3, VI and V.1 do not exceed $1,000. It also applies for a taxation year if the corporation's "first instalment base" for the year, as defined in section 5301 of the Regulations, does not exceed $1,000.

Subparagraph 157(1)(*b*)(i) is amended so that, where a corporation is associated with another corporation in a taxation year that ends in a calendar year, the corporation's remainder of tax payable is due two months (rather than three months) after the end of that taxation year where the total business limits of all such corporations for their last taxation years ending in the preceding calendar year exceeds the total taxable incomes of all such corporations for those last taxation years. This amendment applies to the 1998 and subsequent taxation years.

The purpose of this amendment is to provide consistent treatment for corporations within an associated group of corporations with respect to the determination of the date by which their remainders of tax are due. This amendment is consistent with the definition "qualifying corporation" in subsection 127.1(2), which applies for the purposes of determining a corporation's eligibility for refundable investment tax credits.

Subparagraph 157(1)(*b*)(i) and subsections 157(2) and (3) are amended to provide that, for the purposes of section 157, taxable income for a taxation year (as well as Part I.3 and Part VI tax for the year) are determined before taking into consideration "specified future tax consequences" for the year. "Specified future tax consequences" (which is described in greater detail in its new definition in subsection 248(1) of the Act) refers to adjustments arising because of the carryback of losses or similar amounts or because of corrections of certain amounts renounced in connection with the issue of flow-through shares. This amendment applies to amounts that become payable after 1995.

The purpose of this amendment is to ensure that subsequent events do not affect the obligation to pay tax instalments and remainders of tax payable on a timely basis.

Clause 50

Interest

ITA
161

Section 161 of the Act provides that interest is payable by a taxpayer on any outstanding amount of tax payable under Part I for a taxation year, as well as any late or deficient instalments in respect of such tax.

Subclause 50(1)

ITA
161(1)

Subsection 161(1) of the Act provides for interest payable by taxpayers on unpaid taxes for a taxation year. The interest under this subsection is payable by a taxpayer for a taxation year in respect of the period that begins after the day on or before which the taxpayer's remainder of taxes payable for the year is required to be paid.

Subsection 161(1) is amended so that this day is now referred to as a taxpayer's "balance-due day". This amendment is consequential on the amendment to the definition of "balance-due day" in subsection 248(1) of the Act, which extends the application of the definition to corporations.

This amendment applies to the 1996 and subsequent taxation years.

Subclause 50(2)

ITA
161(2.2)

Subsection 161(2.2) of the Act provides for an offset (generally referred to as "contra interest") in computing arrears interest payable under the Act by a taxpayer, where the taxpayer has remitted income tax instalments earlier than the taxpayer was required to or in larger amounts than were required. The contra interest for a taxation year is computed in respect of the period beginning at the start of the year and ending on the day that the taxpayer is required to pay the balance of the taxpayer's estimated taxes for the year.

Subsection 161(2.2) is amended so that the last day of this period for a taxpayer that is a corporation is referred to as the taxpayer's "balance-due day". This amendment is strictly consequential on the amendment to the definition of "balance-due day" in subsection 248(1), which extends the application of the definition to corporations.

This amendment applies to the 1996 and subsequent taxation years.

Subclauses 50(3) and (4)

ITA
161(4)(*a*) and (4.01)(*a*)

Subsections 161(4) and (4.01) of the Act limit the liability of individuals for interest with respect to deficient instalments of tax. In conjunction with sections 155 and 156, subsections 161(4) and (4.01) provide that instalments for this purpose are determined under the indicated method that gives rise to the smallest instalments. One of the indicated methods for individuals (other than certain farmers and fishermen) is to pay quarterly instalments of the individual's current tax payable for the year. (Because of subsection 161(7), the latter amount is determined before considering the consequences of the deduction or exclusion of loss carrybacks and other amounts described in paragraph 161(7)(*a*).)

Paragraph 161(4)(*a*) and (4.01)(*a*) are amended so that, for this purpose, an individual's tax payable for a taxation year is also computed before considering the consequences of reductions of amounts purported to be renounced after the beginning of the year pursuant to the new one year look-back rule described in the commentary to amended subsection 66(12.66). These consequences are included in the new definition "specified future tax consequences" in subsection 248(1). For further detail, see the commentary on the new definition.

These amendments apply to the 1996 and subsequent taxation years.

Subclause 50(5)

ITA
161(4.1)(*a*)

Subsection 161(4.1) of the Act limits the liability of corporations for interest with respect to deficient instalments of tax. In conjunction with section 157, subsection 161(4.1) provides that instalments for this purpose are determined under the indicated method that gives rise to the smallest instalments. One of the indicated methods for corporations is to pay monthly instalments of the corporation's current tax payable for the year. (Because of subsection 161(7), the

latter amount is determined before considering the consequences of the deduction or exclusion of loss carrybacks and other amounts described in paragraph 161(7)(*a*).)

Paragraph 161(4.1)(*a*) is amended so that, for this purpose, a corporation's tax payable for a taxation year is also computed before considering the consequences of reductions of amounts purported to be renounced after the beginning of the year pursuant to the new one year look-back rule described in the commentary to amended subsection 66(12.66). These consequences are included in the new definition "specified future tax consequences" in subsection 248(1). For further detail, see the commentary on the new definition.

This amendment applies to the 1996 and subsequent taxation years.

Subclause 50(6)

ITA
161(6.2)

New subsection 161(6.2) of the Act applies where a taxpayer's tax payable under Part I for a taxation year is more than it otherwise would be because of a "specified future tax consequence" for the year that is described in paragraph (*b*) of that expression, which is now defined in subsection 248(1) of the Act. The consequence so described is the consequence of a reduction under subsection 66(12.73) of the Act of an amount purported to be renounced under subsection 66(12.6) or (12.601) because of the application of subsection 66(12.66). Where subsection 161(6.2) applies to a taxpayer for a taxation year, the taxpayer's Part I tax account for the year is, on the taxpayer's balance-due day for the year, credited with an amount equal to such additional tax payable. The account is subsequently debited, on April 30 of the calendar year that follows the year of the renunciation, with the same amount.

The main purpose of this rule, in conjunction with the amendments to the Act and the *Income Tax Regulations* with respect to tax instalments, is to avoid arrears interest from being payable by an investor because of adjustments to renunciations made as a consequence of the new one year look-back rule provided under amended subsection 66(12.66). In effect, a taxpayer in these circumstances has a grace period until April 30 of the calendar year

following the calendar year in which the renunciation was made. (Note, in addition, that subsection 161(6.2) is also relevant in determining refund interest payable to a taxpayer) under section 164 of the Act because of its effect on a taxpayer's "overpayment" of tax, as determined under subsection 164(7).)

For further detail, reference may be made to the commentary on the definition "specified future tax consequence" in subsection 248(1). For commentary on related amendments to the Regulations, see Appendix C to these explanatory notes.

This amendment applies to the 1996 and subsequent taxation years.

Subclause 50(7)

ITA
161(7)(*a*)(ix) and (x)

Paragraph 161(7)(*a*) of the Act applies where tax payable under Part I, I.3 or VI is reduced because of the carryback of a loss, tax credit or other amount from a subsequent year. Where this is the case, interest payable on unpaid taxes is determined without regard to the reduction until a date determined under paragraph 161(7)(*b*).

The English version of subparagraphs 161(7)(*a*)(ix) and (x) has been corrected so that reductions of the tax payable under Part I.3 and VI for a taxation year as a consequence of a deduction for the year under subsection 181.1(4) or 190.1(3) of the Act are linked to unused credits for a subsequent taxation year. (The existing law erroneously refers in this context to deductions for the subsequent year.)

Amended subparagraph 161(7)(*a*)(ix) applies to the 1992 and subsequent taxation years. Amended subparagraph 161(7)(*a*)(x) applies to the 1991 and subsequent taxation years.

Subclause 50(8)

ITA
161(11)

Subsection 161(11) of the Act provides for the payment of interest on late-paid penalties assessed under section 163.1 of the Act for

deficient tax instalments. In the case of a taxpayer's penalty for a taxation year, the interest is computed from the day on which the remainder of the taxpayer's tax payable under Part I for the year is payable.

Paragraph 161(11)(*b*) is amended so that this day is referred to as the taxpayer's "balance-due day". This amendment is consequential on the amendment to the definition "balance-due day" in subsection 248(1) of the Act, which extends the application of the definition to corporations.

This amendment applies to the 1996 and subsequent taxation years.

Clause 51

Penalties

ITA
162

Section 162 imposes penalties for infractions such as failing to provide certain information or failing to file a return for a taxation year.

Subclause 51(1)

ITA
162(7)

Subsection 162(7) of the Act provides a penalty for the failure to file an information return and for the failure to comply with a duty or obligation imposed under the Act or the Regulations. The penalty is equal to $25 per day of default, subject to a $100 minimum and a $2,500 maximum.

Subsection 162(7) is amended to provide that the penalty also applies to partnerships. This is because new sections 233.3, 233.4 and 233.6 of the Act require both persons and partnerships to file information returns. Failure to file such returns will, therefore, result in a partnership being liable for the penalty under subsection 162(7).

Subsection 162(7) is also amended so that, where a person or partnership is liable to a penalty under amended subsection 162(10) or new subsection 162(10.1) in respect of the failure to file an information return under sections 233.1 to 233.4, that person or partnership can also be liable to the penalty under subsection 162(7). However, the penalties under subsections 162(10) and (10.1) are reduced by the penalty payable by the person or partnership under subsection 162(7).

Subsection 162(7) is also amended to ensure that this penalty applies in respect of the obligation of a corporation to file a statement under amended subsection 66(12.73) of the Act, notwithstanding the late filing penalty provided under subsections 163(2.21) and (2.22).

These amendments apply to information returns required to be filed after December 30, 1997 and to duties and obligations first imposed after that day.

ITA
162(7.1)

Subsection 162(7.1) of the Act imposes a penalty on a partnership where a member of the partnership fails to file a partnership information return as and when required by the Act or the regulations. The penalty is equal to $25 per day of default, subject to a $100 minimum and a $2,500 maximum.

Subsection 162(7.1) is amended to ensure that a partnership and its members cannot be concurrently liable for a penalty under amended subsection 162(10) and subsection 162(7.1) in respect of the same failure to comply.

This amendment applies to information returns that are due after December 30, 1997.

Subclause 51(2)

ITA
162(8.1)

Subsection 162(8.1) of the Act allows the penalties imposed under subsections 162(7.1) and (8) to be assessed against a partnership and applies the provisions of the Act relating to assessments, objections and appeals with respect to those penalties as if the partnership were a corporation.

Subsection 162(8.1) is amended so that it also applies to penalties imposed under subsections 162(7), (10) and (10.1). These amendments are required because the penalties under amended subsections 162(7) and (10) and new subsection 162(10.1) are applicable to both persons and partnerships.

This amendment applies to information returns due after December 30, 1997.

Subclause 51(3)

ITA
162(10) and (10.1)

Subsection 162(10) of the Act levies a penalty for failure to file an information return under section 233.1 in respect of non-arm's length transactions between non-resident persons and corporations resident in Canada or carrying on business in Canada. The penalty under existing subsection 162(10) applies only where a corporation is served with a demand for the information return and does not comply with the demand within 90 days of service. The penalty imposed for a failure to meet this requirement is equal to $1,000 for each of the first 24 months during which such failure continues.

Subsection 162(10) is amended so that it applies to persons or partnerships who, knowingly or under circumstances amounting to gross negligence, fail to file information returns required to be filed under new sections 233.2 to 233.4, whether or not a demand is served for the returns.

The penalty under subsection 162(10) applies in two mutually exclusive situations described by paragraphs 162(10)(*a*) and (*b*). The first situation arises where a person or partnership, knowingly or under circumstances amount to gross negligence, fails to file an information return as and when required by any of sections 233.1 to 233.4. Where no demand has been served for the return, the penalty is $500 per month for up to 24 months. If a demand is served and not complied with, the penalty is $1,000 per month. It begins to run from the month in which the return was required to be filed. The second situation arises where a person or partnership required to file a return under any of sections 233.1 to 233.4 has, knowingly or under circumstances amounting to gross negligence, failed to comply with a demand served under section 233 to file the return. The penalty in this case is $1,000 per month for up to 24 months. It begins to run from the month in which the demand was served. The second situation exists only if the first situation does not. More specifically, for paragraph 162(10)(*b*) to apply, the failure to file the return as and when required by any of sections 233.1 to 233.4 cannot have been done knowingly or under circumstances amounting to gross negligence. In both situations, the penalty payable under subsection 162(7) in respect of the failure to file the return reduces the penalty under subsection 162(10).

Subsection 162(10.1) is introduced so that, in the case of information returns under sections 233.2 to 233.4, an additional penalty is imposed where the person or partnership required to file an information return is liable for the penalty under subsection 162(10) and the return is more than 24 months late.

The additional penalty under subsection 162(10.1) is equal to a specified amount with respect to an information return, minus the penalties determined under subsections 162(7) and(10) for the failure to file the return. The specified amount with respect to an information return under section 233.2 is equal to 10% of the total fair market value of property transferred or loaned to the trust that gave rise to an obligation to file the return. The specified amount with respect to an information return under section 233.3 for a taxation year or fiscal period is 10% of the greatest total cost amount to the reporting person or partnership of "specified foreign property" (as defined by section 233.3) in the year or period. The specified amount with respect to an information return on a foreign affiliate under

section 233.4 is equal to 10% of the greatest total cost amount to the reporting person or partnership of shares and debt in the affiliate that are owned by the reporting person or partnership.

Further rules for determining the specified amount with respect to an information return under section 233.4 are contained in new subsections 162(10.2) to (10.4).

These amendments apply to returns due after December 30, 1997.

ITA
162(10.2) to (10.4)

New subsections 162(10.2) to (10.4) of the Act provide rules that apply for the purposes of determining the additional penalty imposed under subsection 162(10.1) with respect to the failure to file an information return under new section 233.4. This additional penalty applies where a person or partnership has, knowingly or under circumstances amounting to gross negligence, failed to file an information return in respect of a foreign affiliate of the person or partnership and the failure to file lasts for more than 24 months. The penalty equals the amount by which 10% of the greatest total cost amount to the person or partnership of shares or debt of the foreign affiliate in respect of which the return was not filed exceeds the penalties payable under subsections 162(7) and (10) in respect of the failure to file the required return.

New subsection 162(10.2) provides that any shares or indebtedness owned by a controlled foreign affiliate of a person or partnership are deemed to be owned by the person or partnership. It also ascribes a cost amount to such shares or debt equal to 20% of their cost amount to the controlled foreign affiliate. As a consequence, the penalty in subsection 162(10.1) can apply where the person or partnership required to report in respect of the affiliate does not own shares or debt of the affiliate, but, rather, has an interest in the shares through one or more controlled foreign affiliates.

New subsection 162(10.3) provides rules to ensure that partnerships have foreign affiliates and controlled foreign affiliates for the purposes of subsections 162(10.1) and (10.2).

New subsection 162(10.4) provides rules which, for the purposes of the additional penalty under subsection 162(10.1), treat non-resident trusts as foreign affiliates or controlled foreign affiliates of their beneficiaries, in the event they are treated as such for the purposes of the reporting requirements under section 233.4. In addition, a cost amount is ascribed to shares deemed to be issued by such trusts to beneficiaries. The cost amount to beneficiaries of shares deemed to be issued by such trusts is based on the fair market value of beneficiaries' interests in the trust.

Subsections 162(10.2) to (10.4) apply to information returns due after December 30, 1997.

Subclause 51(4)

ITA
162(11)

Subsections 162(1) and (2) of the Act provide penalties for a person's failure to file a return for a taxation year. These penalties are computed with reference to the person's unpaid tax when the return was required to be filed. Subsection 162(11) ensures that the carryback of losses and similar amounts pursuant to subsection 161(7) cannot reduce the amount of such penalties.

Subsection 162(11) is amended so that, for this purpose, a person's tax payable for a taxation year is also computed before considering the consequences of reductions of amounts purported to be renounced after the beginning of the year pursuant to the new one year look-back rule described in the commentary to amended subsection 66(12.66). These consequences, as well of the consequences of carrying back losses and similar amount pursuant to subsection 161(7), are now referred to as "specified future tax consequences". For further detail, see the commentary on the new definition of this expression.

This amendment applies to the 1996 and subsequent taxation years.

Clause 52

Penalties

ITA
163

Section 163 of the Act imposes penalties in respect of serious failure to comply with the Act, such as making false statement or omitting to report income.

Subclauses 52(1) and (2)

ITA
163(2.2) to (2.22)

Subsection 163(2.2) of the Act provides a penalty where a taxpayer makes a false statement or omission in a renunciation of resource expenses under subsection 66(12.6), (12.601), (12.62) or (12.64).

Subsection 163(2.2) is amended to eliminate the reference to subsection 66(12.64), strictly as a consequence of the repeal of the latter subsection. This amendment applies to renunciations made after 1998.

Subsection 163(2.2) is also amended so that it does not apply to renunciations that use the one year look-back rule in subsection 66(12.66). Instead, a penalty in this regard is provided under new subsections 163(2.21) and (2.22).

The new penalty with respect to the look-back rule applies in two cases. The first case is where a person, knowingly or under circumstances amounting to gross negligence has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a document required to be filed under subsection 66(12.73) in respect of a renunciation purported to be made because of the application of subsection 66(12.66). The second case is where the person fails to file the document on or before the day that is 24 months after the day by which it was required to be filed.

The new penalty for which a person is liable is equal to 25% the excess renounced, determined as of the end of the year of the renunciation. However, the excess is determined with reference only to information that the person knew or ought to have known at the end of the year. In addition, the penalty is reduced to reflect the adjustments set out in the written statement filed under subsection 66(12.73), not more than 24 months after the filing deadline for the written statement. (Note, in this regard, that penalties for late filing of the written statement are also provided under amended subsection 162(7).)

Except as noted above, these amendments apply after Royal Assent.

Subclause 52(3)

ITA
163(2.4)

New subsection 163(2.4) of the Act provides a penalty for a person or partnership who, knowingly or under circumstances amounting to gross negligence, has made or has participated in, assented to, or acquiesced in the making of a false statement or omission in a return required to be filed under any of sections 233.1 to 233.6 of the Act. In determining whether an omission has been made to which subsection 163(2.4) applies, reference should be made to the commentary on the due diligence exception in new subsection 233.5.

The penalty in respect of an information return under section 233.1 is $24,000. The penalty in respect of information returns under sections 233.2 to 233.4 is the greater of $24,000 and 10% of

- in the case of an information return under section 233.2, the total fair market value transferred or loaned that gave rise to the filer’s obligation to file the return;

- in the case of an information return under section 233.3, the greatest total cost amount to the person or partnership of specified foreign property in respect of which the false statement or omission was made; and

- in the case of an information return under section 233.4, the greatest total cost amount to the person or partnership of shares and debt of the foreign affiliate in respect of which the return is being filed.

The penalty in respect of an information return under section 233.6 is the greater of $2,500 and 10% of the total of two amounts: the fair market value of property distributed to the person or partnership and the greatest unpaid principal amount of each debt that is owing to the trust by the person or partnership.

In some cases, a person who makes an omission with respect to an information return may claim that the omission is attributable to foreign privacy laws. Subsection 163(2.4) is intended to apply to the omission made by a person who made a transfer or loan and knew, or ought to have known, that foreign privacy laws would preclude compliance with Canadian reporting requirements.

Subsection 163(2.4) applies to information returns due after December 30, 1997.

ITA
163(2.5) to (2.91)

New subsections 163(2.5) to (2.91) of the Act provide rules which are relevant for the purposes of determining the penalties under subsection 163(2.4) in respect of information returns filed under sections 233.3 to 233.6.

New subsection 163(2.5) applies for the purposes of determining the penalty under subsection 163(2.4) in respect of information returns filed under section 233.4 of the Act. This penalty is based, in part, on the cost amount to the reporting person or partnership of shares and debt of the foreign affiliate in respect of which the return was made. Paragraph 163(2.5)(*a*) provides that any shares or indebtedness owned by a controlled foreign affiliate of a reporting person or partnership are deemed to be owned by the person or partnership.
Paragraph 163(2.5)(*b*) ascribes a cost amount to such shares or debt equal to 20% of their cost amount to the controlled foreign affiliate. As a consequence, this penalty applies where the reporting person or

partnership does not own shares or debt of a foreign affiliate, but, rather, has an interest in the shares through one or more controlled foreign affiliates.

New subsection 163(2.6) provides rules to ensure that partnerships have foreign affiliates and controlled foreign affiliates for the purposes of subsections 163(2.4) and (2.5).

New subsection 163(2.7) provides, for the purpose of the penalties under subsection 163(2.4) in respect of false statements or omissions in an information return required to be filed under new sections 233.3, 233.4 and 233.6 of the Act, that each act or omission of a member of a partnership is deemed to be an act or omission of the partnership required to file the return.

New subsection 163(2.8) provides, for the purpose of subsection 163(2.7), that a person who is a member of a partnership which in turn is a member of another partnership is deemed to be a member of the other partnership. As a consequence, the Minister of National Revenue may look through tiers of partnerships in order to establish the persons responsible for making false statements or omissions in a return filed under any of sections 233.3 to 233.6 by a partnership.

New subsection 163(2.9) allows the penalty imposed under new subsection 163(2.4) to be assessed against a partnership and applies the provisions of the Act relating to assessments, objections and appeals with respect to those penalties as if the partnership were a corporation.

New subsection 163(2.91) provides rules which, for the purposes of the penalty provided under subsection 163(2.4) in respect of information returns for foreign affiliates, treat non-resident trusts as foreign affiliates or controlled foreign affiliates of their beneficiaries, in the event they are treated as such for the purposes of the reporting requirements under section 233.4. In addition, a cost amount is ascribed to shares deemed to be issued by such trusts to beneficiaries. The cost amount to beneficiaries of shares deemed to be issued by such trusts is based on the fair market value of beneficiaries’ interests in the trust.

Subsections 163(2.5) to (2.91) apply to information returns due after December 30, 1997.

Clause 53

Tax on Capital of Financial Institutions – Calculation

ITA
190.1

Part VI of the Act levies a tax on the taxable capital employed in Canada of financial institutions. In general terms, a financial institution's taxable capital employed in Canada is the amount of its long-term debt, equity and non-deductible reserves that are considered to be used in connection with its activities carried on in Canada.

Subclause 53(1)

ITA
190.1(1.1)

Subsection 190.1(1.1) of the Act imposes an additional temporary Part VI tax on the capital employed in Canada for a taxation year of life insurers in excess of their "capital allowance". The effective additional amount of Part VI tax, levied on the basis of the following ranges of taxable capital employed in Canada, that a life insurer is liable to pay, is:

	Temporary Tax	**Existing Tax**	**Total Part VI Tax**
(millions of dollar)			
10-50	0.5%	---	0.5%
50-100	0.75%	---	0.75%
100-200	1.0%	---	1.0%
200-300	0.5%	1.0%	1.5%
over 300	0.25%	1.25%	1.5%

The terms "taxable capital employed in Canada" and "capital allowance" are defined in sections 190.11 and 190.16 respectively.

The additional tax, which was introduced in the 1992 budget, was originally scheduled to expire on December 31, 1995; this amendment extends the application of the additional tax until December 31, 1998.

Subclause 53(2)

ITA
190.1(1.2)

Subsection 190.1(1.2) of the Act imposes an additional temporary Part VI tax on the taxable capital employed in Canada of financial institutions, other than life insurance corporations. The additional tax is equal to 0.15% of the corporation's taxable capital employed in Canada in excess of its "enhanced capital deduction" of $400 million. Where the corporation is related to another financial institution at the end of the year, the enhanced capital deduction must be shared by members of the related group.

The additional tax, which was introduced in the 1995 budget, was originally scheduled to expire on October 31, 1996; this amendment extends the application of the additional tax until October 31, 1997. For taxation years that include October 31, 1997, the additional tax will be prorated on the basis of the number of days in the taxation year that are before November 1, 1997.

This amendment applies to taxation years that end after February 27, 1995.

Clause 54

Tax on Non-Qualified Investments and Use of Assets as Security

ITA
198(6)(*d*)

While a trust governed by a deferred profit sharing plan (DPSP) is generally exempt from tax, a special tax under Part X of the Act applies where such a trust acquires a non-qualified investment.

Subsection 198(6) of the Act deems the acquisition of a life insurance policy by a trust governed by a DPSP not to be the acquisition of a non-qualified investment (and thus not to be subject to the taxes imposed on non-qualified investments) where certain conditions are satisfied. One of the conditions is that the cash surrender value of the policy be at least equal to the maximum amount payable by the insurer under the policy by the time the insured person turns 71 years of age. Subsection 198(6) also applies, by virtue of subsection 146(11) of the Act, to policies acquired by trusts governed by registered retirement savings plans.

Subsection 198(6) is amended so that the condition relating to the cash surrender value of a policy must be satisfied by the end of the year in which the insured person turns 69 years of age (70 years of age if the insured person turns 69 years of age in 1996).

This amendment applies to policies acquired after 1996 where, at the end of 1996, the insured person was less than 70 years of age.

Clause 55

Labour-Sponsored Venture Capital Corporations

ITA
204.8

"labour-sponsored funds tax credit"
"original acquisition"
"original purchaser"
"registered labour-sponsored venture capital corporation"
"specified individual"

Section 204.8 of the Act defines terms for the purposes of penalties and taxes under Part X.3 of the Act relating to labour-sponsored venture capital corporations (LSVCCs) registered under that Part. A tax credit is provided under section 127.4 of the Act in respect of the original acquisition of shares issued by corporations registered under Part X.3.

The definition "labour-sponsored funds tax credit" is used for the purpose of the existing definition "specified individual". This

definition is being repealed, as it is no longer necessary in light of amendments to the definition "specified individual".

A "registered labour-sponsored venture capital corporation" is defined as a corporation registered under subsection 204.81(1). This definition is being moved, in revised form, to subsection 248(1) of the Act.

The definition "original acquisition" has been introduced. It is defined in the same way as under amended subsection 127.4(1) and is discussed in the commentary on amendments to section 127.4.

The definitions "original purchaser" and "specified individual", are used in the context of restrictions in relation to the redemption of shares. With respect to LSVCCs incorporated after March 5, 1996, the definition "original purchaser" is being repealed, as it is no longer necessary because of the amendment to
subclause 204.81(1)(*c*)(v)(A)(I) described below. The definition "specified individual" has been clarified. "Specified individual" in respect of a share is the individual whose labour-sponsored funds tax credit increases because of the "original acquisition" of the share, or would increase if the appropriate form were filed and no refund under section 211.9 were made with respect to the share.

Except as noted above, these amendments apply after 1995.

Clause 56

Conditions for Registration

ITA
204.81

Subsection 204.81(1) of the Act permits the Minister of National Revenue to register a corporation as a labour-sponsored venture capital corporation (LSVCC) under Part X.3 of the Act if its articles satisfy specified conditions and other requirements are met. Under paragraph 204.81(6)(*a*), the Minister may revoke the registration if the corporation fails to comply with such provisions.
Paragraph 204.81(1)(*c*) sets out the specified conditions that must be provided in the articles of a corporation, in order for the corporation to be registered as an LSVCC.

Subclauses 56(1) and (2)

ITA
204.81(1)(*c*)(ii) and (iii)

Subparagraph 204.81(1)(*c*)(ii) of the Act sets out the conditions that relate to the authorized capital of an LSVCC. Under this subparagraph, Class B shares are issuable only to and may be held only by the eligible labour body that caused the corporation to be incorporated. Under subparagraph 204.81(1)(*c*)(iii), the business and affairs of the corporation must be managed by a board of directors at least 1/2 of whom are appointed by the eligible labour body that caused the corporation to be incorporated.

Subparagraph 204.81(1)(*c*)(ii) is amended so that Class B shares can be issued to any eligible labour body, not just the eligible labour body that caused the corporation to be incorporated.

Subparagraph 204.81(1)(*c*)(iii) is amended so that the business and affairs of the corporation must be managed by a board of directors at least 1/2 of whom are appointed by Class B shareholders (rather than only by the eligible labour body that caused the corporation to be incorporated).

The purpose of these amendments is to allow for the transfer of responsibilities with respect to an LSVCC from an eligible labour body to another eligible labour body.

These amendments apply to corporations that are incorporated after March 5, 1996. However, corporations that were incorporated on or before that date are permitted to amend their articles in a manner consistent with these amendments. Such amendments would not be grounds for the revocation of the registration of the corporation, as a consequence of amended subsection 204.81(6).

Subclauses 56(3) to (7)

ITA
204.81(1)(*c*)(v) and (vi)

Subparagraphs 204.81(1)(*c*)(v) and (vi) of the Act set out the circumstances in which an LSVCC may redeem shares of its capital

stock. The existing rules generally provide, pursuant to clause 204.81(1)(*c*)(v)(E), a minimum holding period of 5 years.

Subparagraph 204.81(1)(*c*)(v) is amended, in conjunction with the repeal of subparagraph 204.81(1)(*c*)(vi), so that there are no special rules accommodating the early redemption of shares for individuals who have retired from the workforce, attained 65 years of age or ceased to be resident in Canada.

Subclause 204.81(1)(*c*)(v)(A)(I) of the Act is amended to allow shares to be redeemed at any time where the information return issued in respect of the share has been returned to the corporation on written request of the holder. An existing requirement for the information return to be returned within 60 days of the issue of the share has been eliminated.

Clause 204.81(1)(*c*)(v)(E) is amended so that the minimum holding period under the clause is now 8 years (rather than 5 years) from the day on which the share was issued.

Clause 204.81(1)(*c*)(v)(F) is not being amended. However, it should be noted that amendments to regulations under that clause are contemplated for redemptions that occur after 1997 in order to allow redemptions of Class A shares where an amount is withheld by the corporation in accordance with Part XII.5 of the Act. For further detail, see the commentary on new Part XII.5 of the Act and Appendix B to these explanatory notes.

The amendments to subparagraphs 204.81(1)(*c*)(v) and (vi) apply to corporations that were incorporated after March 5, 1996. However, corporations incorporated before March 6, 1996 may wish to make an amendment to their articles that is consistent with the amendment to subclause 204.81(1)(*c*)(v)(A)(I). Such an amendment would not be grounds for the revocation of the registration of the corporation, as a consequence of amended subsection 204.81(6). In addition, redemptions of shares by corporations incorporated before March 6, 1996 will be potentially subject to tax under new Part XII.5.

Subclauses 56(8) and (9)

ITA
204.81(1)(*c*)(vii)(B), (E) and (F)

Clauses 204.81(1)(*c*)(vii)(A) to (F) of the Act set out the circumstances in which an LSVCC may register the transfer of a Class A share. Clause (B) allows the registration if the transfer occurs more than 5 years after the day on which the share was issued. Clause (E) allows the registration in certain cases of death, retirement or change in country of residence. Clause (F) allows the registration in certain cases where individuals attain 65 years of age. The remaining clauses set out other circumstances in which the registration of a transfer is permitted.

Clauses (B) and (F) are being repealed. In addition, clause (E) is modified so that it applies only to cases of death.

The repeal of clause (B) applies to corporations that were incorporated after March 5, 1996. The amendment to clause (E) and the repeal of clause (F) apply to corporations that were incorporated after ANNOUNCEMENT DATE.

Subclause 56(10)

ITA
204.81(6)(*a*) and (*a*.1)

Paragraph 204.81(6)(*a*) of the Act allows for the revocation of the registration of an LSVCC where, at any time, its articles do not comply with the specified conditions set out in paragraph 204.81(1)(*c*). Paragraph 204.81(6)(*a*.1) allows for the revocation of the registration of an LSVCC where it fails to comply with the provisions set out in its articles of incorporation.

Paragraph 204.81(6)(*a*) is amended so that the registration of an LSVCC that was incorporated before March 6, 1996 may not be revoked where the failure to comply arises because of amendments made to its articles, provided that those amendments are consistent with the articles permitted under Part X.3 for an LSVCC that is incorporated after ANNOUNCEMENT DATE.

The English version of paragraph 204.81(6)(*a*.1) is amended to require compliance with an LSVCC's articles, rather than its articles of incorporation. Paragraph 204.81(6)(*a*.1) is also amended so that the registration of an LSVCC that was incorporated before March 6, 1996 may not be revoked where the failure to comply would not be a failure to comply if its articles were consistent with the articles of an LSVCC that could be registered under this Part if it were incorporated after ANNOUNCEMENT DATE.

These amendments apply after March 5, 1996.

Clause 57

Registered Education Savings Plans – Penalty Tax

ITA
204.9

Section 204.9 of the Act provides for a special tax to be paid by individuals with respect to overpayments made to registered education savings plans (RESPs). The purpose of this tax is to limit the amount of tax-deferred income that may be accumulated for any one beneficiary, by limiting the annual and aggregate contributions that may be made into RESPs for a particular individual without attracting a penalty.

An "excess amount", as defined in subsection 204.9(1), is the total amount on which tax under section 204.9 is payable. An excess amount will arise when the total of all contributions made into a RESP for a particular beneficiary either exceeds the annual limit of $1,500 in any year, or causes the total of all payments made for that beneficiary to exceed the lifetime limit of $31,500 (which represents 21 years of contributions into a RESP).

These limits in the definition "excess amount" are being increased to reflect the increase in the annual contribution limit from $1,500 to $2,000. As a result, the amount of $1,500 in paragraph (*a*) is replaced by $2,000, and the lifetime limit of $31,500 is replaced by $42,000.

These amendments apply to taxation years that begin after 1996.

Clause 58

Tax payable by exempt person – "specified stage"

ITA
208(1.1)

Section 208 of the Act imposes a penalty tax on tax-exempt persons in respect of certain royalties and related payments paid to the Crown by the tax-exempt person. The purpose of the tax is to discourage transactions between tax-exempt persons and taxable persons designed to shift the burden of Crown royalties from a taxable to a tax-exempt person. The tax is computed with reference to income from the production of substances that is not beyond a specified stage. The substances specified (petroleum, natural gas and related hydrocarbons and metals and minerals) are those in respect of which Crown royalty deductibility is denied under the Act.

Subsection 208(1.1) is amended to make explicit reference to the production of sulphur, which is a mineral. In the case of sulphur, the specified stage is the marketable sulphur stage. This amendment is consequential on the amendments to paragraphs 12(1)(*o*) and 18(1)(*m*) of the Act denying the deductibility of sulphur Crown royalties.

These amendments apply to taxation years that begin after 1996.

Clause 59

Definitions

ITA
209(1)

"carved-out income"

Subsection 209(1) of the Act defines certain terms for the purposes of the Part XII.1 Tax on Carved-Out Income. Paragraph (*c*) of the definition "carved-out income" in subsection 209(1) is amended to

eliminate the phrase "oil sands deposit" consequential on the introduction of the definition "bituminous sands" in subsection 248(1).

This amendment applies after March 6, 1996.

Clause 60

Definitions

ITA
211(1)

"life insurance policy"
"life insurance policy in Canada"

Subsection 211(1) of the Act provides definitions for the purpose of the tax on the taxable life investment income of a life insurer under Part XII.3. There are two amendments to this subsection: the definition "life insurance policy" is extended to include benefits under, both, group life insurance policies and group annuity contracts, and the definition "life insurance policy in Canada" in subsection 138(12) has been repeated. These amendments apply to the 1996 and subsequent taxation years.

Clause 61

Tax on Investment Income of Life Insurers

ITA
211.1(3)

Section 211.1 of the Act levies a tax at the rate of 15% on the taxable Canadian life investment income of a life insurer. A life insurer's taxable Canadian life investment income is equal to the excess of its Canadian life investment income for a taxation year over the total of the insurer's unused Canadian life investment losses from the seven preceding years. Subsection 211.1(3) provides for the determination of an insurer's Canadian life investment income or loss for a taxation year for these purposes. The amendments to

paragraphs (*a*) and (*b*) of the descriptions of A and D as well as subparagraphs (*c*)(i) and (ii) of the description of E in subsection 211.1(3) are strictly consequential on the amendment to subsection 1401(1) of the *Income Tax Regulations* restricting the application of that Regulation, for the 1996 and following years, to life insurance policies in Canada that are "pre-1996 life insurance policies". These amendments ensure that the Canadian life investment income of the life insurer is determined in respect of all its life insurance policies.

These amendments apply to the 1996 and subsequent taxation years.

Clause 62

Recovery of Labour-Sponsored Funds Tax Credits

ITA
Part XII.5
211.7 to 211.9

New section 211.8 of the Act provides a mechanism for the recovery of a federal tax credit provided under section 127.4 of the Act with respect to shares issued by labour-sponsored venture capital corporations (LSVCCs). New section 211.9 provides authority for the Minister of National Revenue to refund to an individual an amount paid under Part XII.5 of the Act or pursuant to section 6706 of the *Income Tax Regulations*.

ITA
211.7

New section 211.7 of the Act provides definitions for the purposes of Part XII.5.

The definitions "approved share", "net cost", "original acquisition" and "qualifying trust" are defined in the same way as under amended subsection 127.4(1). For details, see the commentary on the amendments to section 127.4.

A "labour-sponsored funds tax credit" in respect of a share is

- if the "original acquisition" of the share occurred before 1996, simply 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 ($5,000 and $3,500) referred to in the commentary on section 127.4.

For LSVCCs registered under Part X.3, the Part XII.5 tax on the disposition of a share is essentially a recovery of the "labour-sponsored funds tax credit" in respect of the original acquisition of the share.

A "revoked corporation" is defined as a corporation the registration of which has been revoked under subsection 204.81(6). For the purpose of Part XII.5, revoked corporations are treated in the same was as LSVCCs.

These amendments apply after March 5, 1996.

ITA
211.8

New section 211.8 of the Act provides a mechanism for the recovery of a federal tax credit under section 127.4 of the Act with respect to the original acquisition of a share issued by an LSVCC. The mechanism is a new tax under Part XII.5 of the Act all or part of which may be refundable pursuant to new section 211.9. Part XII.5 tax applies to the following dispositions:

1. a disposition that occurs after November 15, 1995 of a share issued by an LSVCC, other than an LSVCC (referred to below as a "federally-registered LSVCC") that was never registered under section 204.81,

2. a disposition of a share issued by a federally-registered LSVCC as a consequence of the purchase or acquisition of the share for cancellation by the LSVCC after November 15, 1995, where the share is not redeemed by the LSVCC, and

3. a redemption of a share issued by a federally-registered LSVCC that occur after November 15, 1995, other than a redemption before 1998 to which the existing clawback rules in section 6706 of the *Income Tax Regulations* apply.

The amount of the tax payable under new Part XII.5 on the disposition of a share of the capital stock of a non-federally-registered LSVCC is equal to a specified percentage of the portion of the provincial LSVCC tax credit that is required to be repaid as a consequence of the disposition. The specified percentage for a share reflects the proportion that the federal LSVCC tax credit (more specifically, the "labour-sponsored funds tax credit" in respect of the share) is to the provincial LSVCC credit available on the acquisition of the share. In addition, the amount of the special tax on the disposition of a share will not exceed the proceeds of disposition (net of any provincial LSVCC tax credit recovery).

The special tax payable with respect to such a disposition of a share issued by a federally-registered LSVCC or a revoked corporation is generally charged where the disposition occurs less than 8 years after the share was issued. The special tax payable on the disposition is generally equal to the "labour-sponsored funds tax credit", described above, in respect of the share. However, the special tax under Part XII.5 is not charged on a disposition of such a share where:

- the disposition was a redemption in respect of which the information return to claim the LSVCC tax credit was returned pursuant to subclause 204.81(1)(*c*)(v)(A)(I),

- the disposition was a redemption that occurred pursuant to subclause 204.81(1)(*c*)(v)(A)(III) because an individual became disabled and permanently unfit for work or terminally ill,

- the disposition was a redemption that occurred pursuant to the unusual circumstances to which clause 204.81(1)(*c*)(v)(B) applies (essentially the acquisition of the share was in circumstances where no one could be entitled to a federal LSVCC tax credit in respect of its acquisition), or

- most significantly, in the case of a share the original acquisition of which was before March 6, 1996, where the share is disposed of

- more than 2 years after it was issued where the disposition occurred, pursuant to the terms of the articles of the LSVCC, because an individual attains 65 years of age, retires from the workforce or ceases to be resident in Canada, or

- more than 5 years after it was issued.

As is the case with the special tax on the dispositions of shares of the capital stock of non-federally-registered LSVCCs, Part XII.5 tax in respect of the disposition of a share issued by a federally-registered LSVCC is limited to the proceeds of disposition (net of any provincial tax credit recovery).

New subsection 211.8(2) provides that a person or a partnership that redeems, acquires or cancels an LSVCC share is obliged to withhold, from the amount otherwise payable on the redemption, acquisition, or cancellation to the shareholder, the tax determined under subsection 211.8(1) in respect of the redemption, acquisition or cancellation. The amount withheld is required to be remitted to the Receiver General of Canada, within 30 days after the redemption or acquisition, together with a statement in prescribed form.

Under new subsection 211.8(3), a person or partnership is liable to pay tax under section 211.8 on behalf of a shareholder equal to the amount the person or partnership failed to withhold under subsection 211.8(2). Liability for a failure to remit an amount that was withheld is provided under subsection 227(9.4). Interest penalties for the failure to withhold or remit are provided under amended subsection 227(8.3) and subsection 227(9.2).) The withholding obligation applies to dispositions that occur after Royal Assent.

These amendments apply as of the dates set out above. However, with respect to dispositions before 1998 of shares of the capital stock of non-federally-registered LSVCCs, the shareholder is not liable to the special tax where any portion of the amount required to be remitted to the government of a province as a consequence of the disposition of an LSVCC share was in respect of the recovery of the federal LSVCC tax credit provided under subsection 127.4(2) in respect of the share.

ITA
211.9

New section 211.9 of the Act permits the Minister of National Revenue to refund an amount to an individual where a person has paid an amount in respect of the disposition of the shares under Part XII.5 or, as a consequence of a redemption before 1998, pursuant to section 6706 of the *Income Tax Regulations*. The individual must request such a refund in a written application filed with the Minister no later than 2 years after the end of the calendar year in which the disposition occurred in order for it to be considered.

The amount that may be refunded to an individual by the Minister in respect of the disposition of an approved share cannot exceed a specified amount minus the amount deducted in respect of the original acquisition of the share by the individual under subsection 127.4(2). If the original acquisition was before March 6, 1996, the specified amount in respect of the disposition of the share is equal to 20% of the net cost of the share on the original acquisition. In all other cases, the "20%" reference is read as "15%". Where an amount has been refunded by the Minister to an individual in respect of a disposition of a share under this section, the individual will not be able to claim a higher LSVCC tax credit for a taxation year in respect of the original acquisition of the share in the event that the individual's income for the year is subsequently increased on a reassessment by the Minister. (The special rule for reassessments is contained in new paragraph 127.4(6)(*d*), but a transitional rule for the 1992 to 1995 taxation year to the same effect is reflected in the amendments to subsection 127.4(2).)

The following example illustrates the operation of section 211.9:

EXAMPLE

In August 1997, Joanne acquired $3,500 of shares issued by a federally-registered LSVCC. If Joanne had sufficient taxable income, she would have been able to deduct $525 (15% X $3,500) in computing her federal tax payable. However, she can claim only $200 for her 1997 taxation year. In 1998, the shares are redeemed. The resulting Part XII.5 tax is $525. How much Part XII.5 tax may the Minister refund?

Results:

1. Under section 211.9, the Minister is entitled to refund up to $325. This amount is the lesser of $525 (Part XII.5 tax) and $325 ((15% X $3,500) - $200).

2. Under paragraph 127.4(6)(d), Joanne would not be able to claim a higher tax credit because of the acquisition of the LSVCC shares in the event that her income for the 1997 taxation year is subsequently increased on a reassessment by the Minister.

These amendments apply after Royal Assent.

ITA
Part XII.6

New Part XII.6 of the Act levies a new tax on flow-through shares issuers that use the one year look-back rule for flow-through shares under subsection 66(12.66). Because of that subsection, certain Canadian exploration expenses (CEE) and Canadian development expenses (CDE) incurred in a calendar year can be flowed through to an investor and treated as if they had been incurred at the end of the preceding calendar year. Part XII.6 provides for a tax, which compensates the fisc for the acceleration of the deduction resulting from the application of subsection 66(12.66) of the Act. Because of amended paragraph 18(1)(*t*) and new paragraph 20(1)(*nn*) of the Act, Part XII.6 tax is deductible in computing an issuer's income. An additional tax under Part XII.6 is levied in the event that flow-through share funds in these circumstances have not been spent by the end of the calendar year of the renunciation. The further tax represents an administrative charge for the extra costs associated with retroactive adjustments necessitated by excessive renunciations.

More specifically, subsection 211.91(1) applies where, because of the application of subsection 66(12.66), a corporation purports to renounce an amount in a calendar year under subsection 66(12.6) or (12.601). Where this is the case, the corporation must pay a tax in respect of each month (other than January) in the year of the renunciation. The tax per month is generally equal to the balance of funds at the end of the month in respect of the renunciation that have not been spent on qualifying CEE or CDE, multiplied by an interest rate. The interest rate is equal to 1/12 of the annual interest rate

prescribed for the purposes of determining refund interest under subsection 164(3) of the Act. However, if funds remain unspent at the end of the year of the renunciation, there is an extra charge levied for December equal to 1/10 of the unspent balance at the end of that month.

A special relieving rule applies for amounts purported to be renounced in respect of expenses incurred or to be incurred in connection with production or potential production in a particular province where a tax analogous to Part XII.6 tax is payable by the renouncing corporation under the laws of that province. In order to provide room for a parallel provincial tax in these circumstances, the Part XII.6 tax has been structured so that it is equal to one-half of the amount otherwise determined.

Under subsection 211.91(2), the tax under Part XII.6 for a corporation in respect of a calendar year is calculated in a special return that, together with the tax, is due by the end of February of the following calendar year. Under subsection 211.91(3), the administrative provisions of Part I of the Act apply, with necessary modifications, to Part XII.6.

EXAMPLE

A flow-through share agreement is entered into in 1996. The consideration given by the investor, Raymond, is $10,000. The issuing corporation renounces the full $10,000 to Raymond under subsection 66(12.6) and (12.66), but actually spends only $800 per month beginning in March 1997 and ending in December 1997.

Results:

1. Raymond files his income tax return for the 1996 taxation year on the basis of the $10,000 renunciation.

2. Because the corporation has not spent the full amount renounced by the end of 1997, it is required to file a statement under subsection 66(12.73) with the Minister of National Revenue reflecting the $2,000 deficiency. The statement must be filed by March 1, 1998.

3. Consequently, the Minister would be expected to reassess Raymond for the 1996 taxation year. However, because of new subsection 161(6.2) of the Act, Raymond's arrears interest in respect of the period ending on April 30, 1998 is determined without reference to the $2,000 deficiency. In addition, amendments to the Act and Regulations ensure that Raymond's tax instalment obligations are not affected by the deficiency.

4. The corporation would be required under subsection 211.91(1) to compute a monthly tax for the unspent balances in 1997. Assuming the prescribed rate throughout 1997 is 8%, the total tax under that subsection would be $640. This tax is the sum of $440 (8% x 1/12 x ($10,000 + 9,200 + 8,400 + 7,600 + 6,800 + 6,000 + 5,200 + 4,400 + 3,600 + 2,800 + 2,000) and $200 (10% of the unspent balance ($2,000) at the end of 1997). The corporation would file the applicable return by February 28, 1998 under subsection 211.91(2).

5. The total $640 tax is deductible in computing the income of the corporation under new paragraph 20(1)(nn).

New Part XII.6 applies to the 1997 and subsequent calendar years.

Clause 63

Tax on the Income of Non-Residents

ITA
212(1)(*f*)

Section 212 of the Act imposes a tax of 25% (reduced by many treaties) on certain amounts paid or credited to non-residents by residents of Canada. By virtue of paragraph 212(1)(*f*), these amounts include support payments to non-residents, if such support payments would be including in computing the non-resident's recipient's income if he or she were resident in Canada.

Paragraph 212(1)(*f*) is repealed, with application to amounts paid and credited after April 1997. This repeal is consequential on the new tax

treatment of child support payments, under which such payments will not be included in computing a recipient’s income under certain circumstances.

Clause 64

Alternative Taxation of Canadian Benefits

ITA
217

Part XIII of the Act imposes a tax on certain Canadian-source income of non-residents. The sorts of income currently subject to Part XIII tax include alimony, maintenance payments, pension benefits (including *Old Age Security* and *Canada Pension Plan* benefits), and payments from RRSPs, RRIFs, deferred profit sharing plans and retirement compensation arrangements. Section 217 of the Act allows a non-resident who receives income of these types to choose not to be taxed under Part XIII on that income. Instead, a non-resident who elects under section 217 adds that income in computing the non-resident’s taxable income earned in Canada (or taxable income, if the non-resident was resident in Canada for part of the year). This means that the retirement and other income described above is subject to tax at ordinary rates under Part I of the Act, instead of the flat 25% rate (often reduced by treaty) under Part XIII.

Section 217 is amended, for the 1997 and subsequent taxation years, to provide that in determining the Part I tax rate that applies where a non-resident elects under the section, the non-resident’s non-Canadian income (and Canadian-source income subject to Part XIII but not eligible for the section 217 election) is taken into consideration. This will not mean that Canada will tax that other income under Part I, but only that the foreign income may increase the rate of tax that applies to the non-resident’s Canadian-source Part I income.

Other modifications simplify section 217 and remove the requirement that more than half a non-resident’s income be included in the non-resident’s taxable income earned in Canada in order for any Part I tax credits to be available.

New subsection 217(1) of the Act defines a non-resident person's "Canadian benefits" for a taxation year as the total of amounts paid or credited in the year and in respect of which Part XIII tax would, but for section 217, be payable because of certain provisions in Part XIII. Those provisions – and thus the sorts of income that are included in "Canadian benefits" – are the following:

212(1)(*h*)	superannuation or pension benefits, with certain exceptions;
212(1)(*j*)	benefits described in subparagraphs 56(1)(*a*)(iii) to (vi) (death benefits, most *Employment Insurance Act* benefits, various forms of government assistance), or paragraphs 56(1)(*x*) or (*z*) of the Act (amounts received out of retirement compensation arrangements);
212(1)(*j*.1)	retiring allowances;
212(1)(*k*)	payments from registered supplementary unemployment benefit plans
212(1)(*l*)	payments out of registered retirement savings plans (RRSPs);
212(1)(*m*)	payments out of deferred profit sharing plans; and
212(1)(*q*)	payments out of registered retirement income funds (RRIFs).

New subsection 217(2) of the Act provides that a non-resident who elects, in a return of income under Part I of the Act within 6 months after the end of a taxation year, to have section 217 apply for the year, is not liable to tax under Part XIII of the Act in respect of the non-resident's Canadian benefits for the year.

It should be noted that Part I's normal filing due dates for individuals apply as well to elective Part I returns under section 217. The 6-month deadline described in subsection 217(2) is not an extension of those due dates, but rather establishes the last date on which the elective return may be validly filed at all.

New subsection 217(3) of the Act describes how a non-resident person who elects to have section 217 apply for a given year computes taxable income earned in Canada (TIEC) for the year. The person is deemed to have been employed in Canada in the year, and is deemed to have TIEC for the year equal to the greater of two amounts. The first amount, described in subparagraph 217(3)(*b*)(i), is essentially the amount that would be the person's TIEC if section 115 of the Act included the person's Canadian benefits in TIEC (the provision also modifies the paragraph 115(1)(*f*) deduction for this purpose). The second amount, in subparagraph 217(3)(*b*)(ii), is the person's income for the year, less any deductions in computing taxable income that can reasonably be considered wholly applicable to the person's Canadian-source Part I income (not including the Canadian benefits).

This means, for example, that a non-resident person who has $10,000 in Canadian benefits for a year, and $40,000 in foreign-source income, will be deemed under new subsection 217(3) to have a TIEC of $50,000 (assuming no deductions in computing taxable income). Again, this does not mean that the non-resident will pay Canadian tax on the $40,000 of foreign income: new subsection 217(6) provides a special credit to offset the Canadian tax on such income.

New subsections 217(4) and (5) of the Act set out the rules under which tax credits, other than the special subsection 217(6) credit, will be available to a non-resident person who chooses to have section 217 apply for a taxation year. Subsection 217(4) provides that sections 118 to 118.91 and 118.94 (which include the various tax credits and govern their availability to non-residents) apply only where all or substantially all of the person's income for the year is included in computing the amount determined under subparagraph 217(3)(*b*)(i) (or in computing taxable income for the year, where the person is a part-year resident of Canada).

Sections 118 to 118.91 and 118.94 will therefore typically apply in their ordinary form only where the person's Canadian benefits, together with the other Canadian-source income and gains described paragraphs 115(1)(*a*) and (*b*) of the Act, make up all or substantially all of the person's income. Where this is not the case, new subsection 217(5) nonetheless allows the non-resident certain credits. Specifically, the non-resident may deduct from the non-resident's Part I tax the lesser of: a subset of the credits provided in

sections 118 to 118.9; and the "appropriate percentage" (in effect the lowest personal tax rate, and thus 17% at this time) of the non-resident's Canadian benefits for the year.

It should be noted that subsection 217(5) is a significant change from the rules in existing section 217. Under the existing rules, a non-resident person who does not meet the test of having all or substantially all income included in computing TIEC may claim a subset of tax credits for a given year only if more than half the person's income for the year is included in computing TIEC for the year. Under subsection 217(5), in contrast, the same subset of credits is available to all non-residents who make the section 217 election and do not meet the "all or substantially all" test.

The subset of credits available under subsection 217(5) includes: the personal credits under section 118; the gift credits under section 118.1; the credit for mental or physical impairment (subsection 118.3(1)); the tuition credit (section 118.5); and the credit for employment insurance and *Canada Pension Plan* contributions (section 118.7). In addition, subsection 217(5) makes available such of the amounts of a number of other credits as may reasonably be considered wholly applicable: the medical expense credit (section 118.2); the credit for an impaired dependant (subsection 118.3(2)); the education tax credit (section 118.6); and unused credits transferred under sections 118.8 and 118.9.

New subsection 217(6) of the Act provides a special credit in computing the tax payable by a non-resident under Part I for a year as a result of a section 217 election. In general terms, this credit is that proportion of the tax otherwise payable that the non-resident's foreign-source income (and non-Part I Canadian-source income, such as dividends) is of the non-resident's total income. The effect of the credit is to exclude foreign-source (and non-Part I) income from Canadian tax, while maintaining the appropriate rate of tax on the non-resident's Part I income, including Canadian benefits.

More specifically, the subsection 217(6) credit is the product of the amount of Part I tax that would be payable by the non-resident for the year and a fraction. The fraction's numerator is the amount by which the amount determined under new subparagraph 217(3)(*b*)(ii)

in respect of the person for the year exceeds the amount determined under new subparagraph 217(3)(*b*)(i) in respect of the person for the year. The fraction's denominator is the 217(3)(*b*)(ii) amount.

Clause 65

Additional Tax on Corporations

ITA
219

Part XIV of the Act imposes what is commonly known as the "branch tax" on corporations, other than Canadian corporations, carrying on business in Canada.

Subclause 65(1)

Non-resident insurers

ITA
219(4)(*a*)(i.1)

Paragraph 219(4)(*a*) of the Act forms the base upon which branch tax is levied on non-resident insurers carrying on an insurance business in Canada. Subparagraph 219(4)(*a*)(i.1) includes in the branch tax base unrealized gains on the transfer of property of an insurer that was "property used by it in the year in, or held by it in the year in the course of" (as defined in subsection 138(12) of the Act) carrying on an insurance business where the gains were deferred under subsection 138(11.5) of the Act on pre-December 16, 1987 transfers of property and under subsection 85(1) of the Act on pre-November 22, 1985 transfers of property.

Subparagraph 219(4)(*a*)(i.1) is amended as a consequence of the replacement of the definition of "property used by it in the year in, or held by it in the year in the course of" in subsection 138(12) with the definition of "designated insurance property". Part XXIV of the *Income Tax Regulations* contains the rules for determining what property is designated insurance property of an insurer.

This amendment applies to the 1996 and subsequent taxation years.

Subclause 65(2)

Additional tax on insurer

ITA
219(5.1)(*a*)

Subsection 219(5.1) of the Act levies branch tax on a non-resident insurer that ceases to carry on all or substantially all of an insurance business in Canada. The tax is levied on the amount by which the insurer's surplus funds from the business plus certain unrealized gains from the disposition of property used in the business exceeds the amount elected under subsection 219(5.2). Subsection 219(5.2) provides a deferral of branch tax in respect of a discontinued business where the non-resident transfers the business to a qualified related corporation. The branch tax must be paid on or before the time that the insurer is required to file an income tax Part I return for the year.

Subsection 219(5.1) is amended as a consequence of the replacement of the definition of "property used by it in the year in, or held by it in the year in the course of" in subsection 138(12) with the definition of "designated insurance property". Part XXIV of the *Income Tax Regulations* contains the rules for determining what property is designated insurance property of an insurer.

Amended subsection 219(5.1) also uses the definition of "filing-due date", which is defined in subsection 248(1) of the Act, as the deadline for the payment of branch tax.

This amendment applies to the 1996 and subsequent taxation years.

Subclause 65(3)

Definitions

ITA
219(7)

Subsection 219(7) of the Act contains definitions for the purposes of Part XIV of the Act.

Currently, the definition of "accumulated 1968 deficit" in subsection 219(7) has the meaning assigned by subsection 138(12). Since that definition has been deleted from subsection 138(12), it is added to subsection 219(7).

A non-substantive amendment is also made by replacing the definition of "attributed surplus for the year" in subsection 219(7) with the definition of "attributed surplus". The definition "attributed surplus" has the meaning assigned by Part XXIV of the *Income Tax Regulations*.

This amendment applies to the 1996 and subsequent taxation years.

Clause 66

Assignment by Corporation

ITA
220(6)

Recent jurisprudence has held that income tax refunds are not generally assignable because of the application of section 67 of the *Financial Administration Act*. To overcome this impediment to financing, the 1996 federal budget proposed to permit the assignment by corporations of expected refunds of SR&ED investment tax credits and the Canadian Film or Video Production Tax Credit. Such a pledge would be binding only as between the parties to the agreement (and other creditors) but not on Revenue Canada.

Proposed subsection 220(6) of the Act provides that a corporation may assign any amount payable to it under the Act. It is therefore somewhat broader than the 1996 federal budget proposal, in that its application is not limited to assignments of certain kinds of investment tax credit refunds.

Proposed subsection 220(7) places certain limitations on the scope of an assignment permitted by subsection 220(6). Subsection 220(7) provides that the assignment of an income tax refund in any way affect the rights or obligations of the Crown. In particular, subparagraphs (*a*), (*b*) and (*c*) specify that the Minister is not required to pay an assignee the assigned amount, that the assignment does not

create any liability of Her Majesty to the assignee and that the rights of the assignee are subject to all equitable and statutory rights of set-off in favour of Her Majesty.

This amendment applies to assignments made after March 5, 1996.

Clause 67

Withholding Taxes

ITA
227

Section 227 of the Act provides special rules relating to source deductions and non-resident withholding tax under sections 153 and 215, respectively, and also deals with the application of certain Parts of the Act to certain persons and entities.

Subclause 67(1)

ITA
227(5)

The rules in subsections 227(5) and (5.1) of the Act provide that a person who has influence over the property or affairs of another person and who authorizes or causes certain payments to be made by the other person that are subject to deductions at source, is deemed to have made the payment and is jointly and severally liable with the other person for any amount payable under the Act in respect of these payments.

Subsection 227(5) is amended so that these rules apply with respect to payments required to be withheld under new Part XII.5 of the Act which levies a special tax with respect to the labour-sponsored funds tax credit.

This amendment applies on Royal Assent.

Subclauses 67(2) and (3)

ITA
227(6) and (7)

Subsection 227(6) of the Act provides for a refund, upon application by a person within a specified time, of excessive amounts of Part XIII tax paid to the Receiver General on behalf of the person. Where the Minister of National Revenue disputes the application, the Minister is required under subsection 227(7) to assess any amount payable under Part XIII by that person.

Subsections 227(6) and (7) are amended so that the same rules apply in respect of applications in respect of amounts paid on account of Part XII.5 liabilities.

This amendment applies on Royal Assent.

Subclauses 67(4) and (5)

ITA
227(8.3)

Subsection 227(8.3) of the Act provides that a person who fails to deduct or withhold an amount, as required by a number of specified provisions, is liable for interest with respect to the amount that the person fails to deduct or withhold. The interest liability is compounded on a daily basis because of the application of subsection 248(11).

Subsection 227(8.3) is amended so that subsection 211.8(2) of the Act is added to the specified provisions. Subsection 211.8(2) requires withholding on account of Part XII.5 tax by persons or partnerships that redeem, acquire or cancel shares of a labour-sponsored venture capital corporations.

This amendment applies on Royal Assent.

Subclause 67(6)

ITA
227(10.01)

Subsection 227(10) of the Act empowers the Minister of National Revenue to assess various amounts payable by a person, including penalties and other amounts payable by a person resident in Canada in respect of the failure to comply with obligations to withhold or pay amounts under Part XIII.

Subsection 227(10.01) is introduced so that the same rule applies in respect of the failure to comply with any obligation to withhold or pay amounts under new Part XII.5 of the Act which levies a special tax in respect of the labour-sponsored funds tax credit.

This amendment applies on Royal Assent.

Subclause 67(7)

ITA
227(10.1)

Subsection 227(10.1) of the Act empowers the Minister of National Revenue to assess various amounts payable by a person, including penalties and other amounts payable by a non-resident person in respect of the failure to comply with any obligation to withhold or pay amounts under Part XIII.

Subsection 227(10.1) is amended so that it also applies in respect of penalties and other amounts payable by a non-resident person in respect of the failure to comply with any obligation to withhold or pay amounts under new Part XII.5 of the Act which levies a special tax in respect of the labour-sponsored funds tax credit.

This amendment applies on Royal Assent.

Subclause 67(8)

ITA
227(15)

Subsection 227(15) of the Act provides that, for the purposes of section 227, a reference to a person with respect to any amount or any tax deducted or withheld from an amount under Part XIII should be considered also to refer to a partnership.

Subsection 227(15) is amended to provide that references to persons in section 227 are considered, for all purposes, to include references to partnerships. One such purpose is the obligation to withhold under new Part XII.5 of the Act whichlevies a special tax in respect of the labour-sponsored funds tax credit.

This amendment applies on Royal Assent.

Clause 68

Information return

ITA
233

Section 233 of the Act authorizes the Minister of National Revenue to demand information from persons required to file information returns. Failure to comply with demands under this section can affect the level of penalties assessed under amended subsection 162(10) of the Act.

Existing section 233 is renumbered as subsection 233(1), as a consequence of the introduction of subsection 233(2). New subsection 233(1) authorizes the Minister of National Revenue to issue a demand to a person to file with the Minister the information designated in the demand or an information return that has not been filed by the person.

New subsection 233(2) authorizes the Minister of National Revenue to issue a demand to a member of a partnership for an information return required to be filed under section 233.3, 233.4 or 233.6 by the

partnership. New subsection 233(3) provides that, for this purpose, a person who is a member of a partnership which in turn is a member of another partnership is deemed to be a member of the second partnership.

These amendments apply to returns due after December 30, 1997.

Clause 69

Foreign Reporting Requirements

ITA
233.2

New section 233.2 of the Act requires certain persons who have made transfers or loans to a specified foreign trust, or to a non-resident corporation that is a controlled foreign affiliate of such a trust, to file annual information returns with respect to the trust. In some cases, persons required to file an information return under section 233.2 may also be required to file an information return under section 233.3 or 233.4 with respect to their interests in a foreign trust.

These amendments apply with respect to taxation years of trusts that begin after 1995. However, no return is due earlier than April 30, 1998.

ITA
233.2(1)

"exempt trust"

There are no reporting requirements under new section 233.2 of the Act with respect to "exempt trusts", as defined in subsection 233.2(1). Three types of trust qualify as "exempt trusts".

The first type of exempt trust is one governed by a "foreign retirement arrangement". Further to the definition of that expression in subsection 248(1) of the Act, foreign retirement arrangements are described in section 6803 of the *Income Tax Regulations*.

The second type of exempt trust is one established in connection with a superannuation, pension or retirement fund or plan or any fund or plan established to provide employee benefits. (However, the exemption applies only where the trust is exempt from income tax imposed by the country of its residence and the trust is maintained primarily for the benefit of non-resident individuals.)

The third type of exempt trust is, in general terms, a foreign mutual fund trust. Reporting in respect of such trusts is, instead, provided under new section 233.3. More specifically, this exemption applies to a trust the interests in which are described by reference to units and which satisfies prescribed conditions. For this purpose, conditions will be prescribed in Part XLVIII of the Regulations. It is proposed to prescribe the following conditions in respect of a trust:

- there are at least 150 beneficiaries who are beneficiaries in respect of the same class of units of the trust, and
- 150 or more of those beneficiaries each hold at least
  - one "block of units" of that class (as defined in Part XLVIII of the Regulations), and
  - units of that class having a total fair market value of at least $500.

ITA
233.2(1)

"specified beneficiary"
"specified foreign trust"

The reporting requirements under new subsection 233.2(4) of the Act apply only in respect of "specified foreign trusts". A "specified foreign trust" is a trust (other than an "exempt trust", as described above) that satisfies two conditions.

The first condition is satisfied if the trust is not resident in Canada. In this context, it is noted that the rule in paragraph 94(1)(*c*) of the Act that deems a non-resident trust to be resident in Canada has no relevance because that rule applies only for the purposes of Part I and sections 233.3 and 233.4 of the Act.

The second condition is satisfied where:

- there is a "specified beneficiary", as described below, under the trust who is resident in Canada, is a corporation or trust with which a person resident in Canada does not deal at arm's length or is a controlled foreign affiliate of a person resident in Canada;

- the terms of the trust permit persons (other than persons beneficially interested in the trust) to be added as beneficiaries under the trust who could be resident in Canada at the time of being so added; or

- the terms of the trust allow property to be distributed, directly or indirectly, to another trust that, immediately after the receipt of the distribution, can reasonably be expected to be a "specified foreign trust".

Subject to an anti-avoidance rule, a "specified beneficiary" under a trust is defined as any person "beneficially interested" in the trust (as defined in subsection 248(25) of the Act), except for excluded beneficiaries. Excluded beneficiaries comprise:

- mutual fund corporations,

- non-resident-owned investment corporations,

- corporations and trusts the taxable income of which is exempt from tax under Part I,

- mutual fund trusts,

- trusts described in any of paragraphs (*a*) to (*e*.1) of the definition "trust" in subsection 108(1) of the Act,

- trusts and corporations registered under Part X.2 of the Act,

- trusts in which each person beneficially interested is an excluded beneficiary described above,

- persons beneficially interested in the trust solely because they are beneficially interested in an "exempt trust" or in another trust that is an excluded beneficiary under the trust, and

- persons who are beneficially interested in the trust only because of a right that is subject to a contingency, where at that time the identity of the person as a person beneficially interested in the trust is impossible to determine. (For example, under a trust for the settlor's unmarried child and the child's future spouse, it would generally be impossible to identify any particular individual as the future spouse.)

Notwithstanding the exclusions above, a "specified beneficiary" under a trust also includes any excluded beneficiary under the trust, if the beneficiary became beneficially interested in the trust in order to limit the reporting in respect of the trust that would otherwise be required.

ITA
233.2(2)

For reporting requirements to apply as of any time with respect to a specified foreign trust, new subsection 233.2(4) of the Act generally provides that a non-arm's length indicator must apply to the trust with respect to an earlier transfer or loan of property. New subsection 233.2(2) describes these non-arm's length indicators.

ITA
233.2(3)

New subsection 233.2(3) of the Act is a special rule which deals with transfers and loans by partnerships. It provides that, for the purposes of section 233.2, property transferred by a partnership is considered to have been transferred or lent by each of the members of the partnership. Consequently, each member of a partnership may be responsible under subsection 233.2(4) for filing an information return for a trust to which the partnership has transferred or loaned property. However, subsection 233.2(5) allows for joint filing of these returns in some cases.

ITA
233.2(4)

New subsection 233.2(4) of the Act imposes reporting requirements that apply in respect of a "specified foreign trust" (as described in the commentary on subsection 233.2(1)) where property has been previously transferred or lent to the trust or to a controlled foreign

affiliate of the trust. For these requirements to apply, a non-arm's length indicator must generally apply to the trust at the end of the year in respect of the transfer or loan. ("Non-arm's length indicators" are defined in subsection 233.2(2).) However, non-arm's length indicators are not relevant where the terms of the trust:

- permit persons to be added as beneficiaries under the trust who might be residents of Canada at the time of being so added, or
- allow property to be distributed, directly or indirectly, to another trust that immediately after the receipt of the distribution can reasonably be expected to be a "specified foreign trust".

Returns required to be filed under this provision by a person, must be filed by the filing deadline for the person's income tax return under Part I of the Act. (However, a transitional rule in the coming-into-force provision for section 233.2 provides that no returns are due before April 30, 1998.)

The person who transferred or lent property as described above is required to file an information return in respect of a taxation year of a trust under paragraph 233.2(4)(*d*). However, this paragraph applies only where such person was resident in Canada at the end of the trust's year.

Where the transferor or lender was a controlled foreign affiliate of a person, that person is required to make an information return in respect of the trust's year under paragraph 233.2(4)(*e*). The requirement of a person to file a return under this paragraph for a trust's taxation year applies only if the person is resident in Canada at the end of the year.

It should also be noted that, at the discretion of the Minister of National Revenue, relief from subsection 233.2(4) may be available under section 220 in certain circumstances.

ITA
233.2(5)

New subsection 233.2(5) of the Act attempts to ease the administrative burden with respect to the reporting required in respect of specified foreign trusts. It allows a person otherwise required to

file an information return for a taxation year of a trust to identify another person required to file the same information return for the year in respect of the trust. The identification is to be made in an election filed in writing with the Minister of National Revenue.

The information return filed by the designated person is then treated as if it were filed by the electing person and as if the filing deadline were the later of the filing deadline otherwise determined for the electing person and the filing deadline for the designated person. The information required on the return is deemed to be the information required of the designated person. Each act and omission of the designated person in respect of the return is treated as an act or omission of the electing person.

ITA
233.3

New section 233.3 of the Act establishes reporting requirements in respect of foreign property. In general terms, it provides that certain taxpayers resident in Canada and certain partnerships must file an information return with respect to their foreign property if the total cost amount of such property exceeds $100,000.

This section applies to taxation years and fiscal periods that begin after 1995. However, returns in respect of taxation years and fiscal periods ending before 1999 are not due before April 30, 1998.

ITA
233.3(1)

New subsection 233.3(1) of the Act defines a number of terms for the purpose of section 233.3.

A "reporting entity" for a taxation year of or fiscal period is defined as a "specified Canadian entity" for the taxation year or fiscal period that, at any time in the year or period while the entity is resident in Canada, owned a "specified foreign property" the total cost amount to the entity of which exceeded $100,000.

A "specified Canadian entity" for a taxation year or fiscal period means

- a taxpayer resident in Canada in the year other than
  - a mutual fund corporation,
  - a non-resident-owned investment corporation,
  - a corporation or trust exempt from tax under Part I,
  - a mutual fund trust,
  - a trust described in paragraphs (*a*) to (*e*.1) of the definition of "trust" in subsection 108(1),
  - trusts and corporations registered under Part X.2 of the Act, or
  - a trust each beneficiary of which is an excluded beneficiary described above, or
- a partnership where the share of the income or loss of the partnership for the fiscal period accruing to or for the benefit of taxpayers not resident in Canada is less than 90% of the total income or loss of the partnership for the period. (For this purpose, a special rule where there is more than one tier of partnerships is provided in new subsection 233.3(2).)

"Specified foreign property" of a person or partnership is defined as the following types of property:

- funds or intangible property held outside Canada (including foreign bank accounts, securities held outside Canada and shares of Canadian companies deposited with a foreign broker);
- tangible property situated outside Canada;
- a share of the capital stock of a non-resident corporation;
- an interest in a non-resident trust (not including an "exempt trust" described in the commentary on subsection 233.2(1) that is not a foreign mutual fund described in that commentary);

- an interest in a partnership that holds any specified foreign property (other than a partnership that is a "specified Canadian entity");
- an interest in, or right with respect to, a non-resident entity;
- indebtedness owed by a non-resident person;
- an interest in or right to any specified foreign property; and
- a property that is convertible into, exchangeable for or confers a right to acquire specified foreign property.

However, such property is excluded from the definition of "specified foreign property" where it is:

- exclusively used or held in the course of carrying on an active business of the person or partnership;
- personal-use property of the person or partnership;
- a share of the capital stock of a foreign affiliate of the person or partnership;
- an interest in a non-resident trust that is either a foreign affiliate of the person or partnership or that was not acquired for consideration by the person or partnership or a person related to the person or partnership; and
- an interest in or right to acquire any such excluded property.

ITA
233.3(2)

New subsection 233.3(2) of the Act provides that a person who is a member of a partnership which in turn is a member of another partnership is deemed to be a member of that other partnership. It also provides that a member's share of the income or loss of a lower tier partnership is deemed to be the amount to which it is directly or indirectly entitled. This provision is relevant in determining whether a partnership is a "specified Canadian entity" and, therefore, whether

the partnership is required to file an information return in respect of its "specified foreign property" under section 233.3.

ITA
233.3(3)

New subsection 233.3(3) of the Act requires a reporting entity for a taxation year or fiscal period to file an information return in prescribed form for the year or period. The information return will provide information in respect of the entity's specified foreign property. As previously discussed, a specified Canadian entity will be a reporting entity if the cost amount of specified foreign property to the entity, at any time in the year while the entity is resident in Canada, exceeds $100,000.

The filing deadline for the information return for a taxation year is the same deadline that applies for the purposes of filing the reporting entity's income tax return for the year under Part I of the Act.

A partnership's information return is required to be filed by the day by which the partnership's return under section 229 of the Regulations must be filed. If no section 229 return is required, the partnership's information return under section 233.3 must be filed by the day by which the section 229 return would be required to be filed if section 229 applied to the partnership.

A transitional rule in the coming-into-force provision for section 233.3 provides that for taxation years or fiscal periods ending before 1999, no return is due before April 30, 1998.

ITA
233.4

New section 233.4 of the Act establishes reporting requirements in respect of foreign affiliates. In general terms, it provides that taxpayers resident in Canada (or certain partnerships) of which a non-resident corporation is a foreign affiliate, must file an information return in respect of the affiliate.

This section applies to taxation years and fiscal periods that begin after 1995. However, returns in respect of taxation years or fiscal periods that end before 1999 are not due before June 30, 1998.

ITA
233.4(1)

New subsection 233.4(1) of the Act defines the expression "reporting entity" for the purpose of section 233.4.

A "reporting entity" for a taxation year or fiscal period means

- a taxpayer resident in Canada of which a non-resident corporation or trust is a foreign affiliate at any time in the year; or

- a partnership where the share of the income or loss of the partnership for the period of members not resident in Canada is less than 90% of the total income or loss of the partnership for the period, and a non-resident corporation or trust would be a foreign affiliate of the partnership at any time in the period if the partnership were a taxpayer resident in Canada.

A reporting entity does not include a taxpayer all of whose income is exempt from tax under Part I of the Act.

ITA
233.4(2)

New subsection 233.4(2) of the Act provides rules for the purpose of determining the foreign affiliate status of a non-resident corporation for the purpose of section 233.4.

In determining whether a non-resident corporation is a foreign affiliate of a taxpayer resident in Canada or a partnership

- paragraph (*b*) of the definition of "equity percentage" in subsection 95(4) is to be read as if the reference in the definition to "any corporation" were read as a reference to "any corporation other than a corporation resident in Canada";

- the definitions of "direct equity percentage" and "equity percentage" in subsection 95(4) are to be read as if a partnership were a person; and

- the definitions of "controlled foreign affiliate" and "foreign affiliate" in subsection 95(1) are to be read as if a partnership were a taxpayer resident in Canada.

The purpose of these rules is to ensure that a non-resident corporation can be a foreign affiliate of only the lowest tier corporation in a group of Canadian corporations under common control. This will limit the circumstances in which the same information is required to be reported by two or more Canadian corporations in respect of the same foreign affiliate. These rules also ensure that a non-resident corporation can be a foreign affiliate of a partnership.

ITA
233.4(3)

New subsection 233.4(3) of the Act provides that a person who is a member of a partnership which in turn is a member of another partnership is considered to be a member of that other partnership. It also provides that a member's share of the income or loss of the other partnership is deemed to be the amount to which it is directly or indirectly entitled. This provision is relevant in determining whether a partnership is a "reporting entity" and, therefore, whether the partnership is required to file an information return under section 233.4.

ITA
233.4(4)

New subsection 233.4(4) of the Act requires a reporting entity for a taxation year or fiscal period to file an information return in prescribed form in respect of each foreign affiliate of the entity in the year or period.

The filing deadline for the information return is 15 months after the end of the reporting entity's taxation year or fiscal period.

A transitional rule in the coming-into-force provision for section 233.4 provides that for taxation years or fiscal periods ending before 1999, no return is due before June 30, 1998.

ITA
233.5

In general terms, where the conditions of new section 233.5 of the Act are met, the penalty, under new subsection 163(2.4), in respect of an omission in an information return required to be filed under new section 233.2 or 233.4 is not applicable in respect of that omission. More specifically, section 233.5 provides that information required in a return filed under section 233.2 or 233.4 does not include information that is not available to the person or partnership required to file the return where the following conditions are met:

- a reasonable disclosure is made in the return of the unavailability of the information;
- the person or partnership exercised due diligence in attempting to obtain the information;
- if the return is filed under section 233.4 in respect of a corporation that is a controlled foreign affiliate of the person or partnership or under section 233.2, it was reasonable for the person or partnership to expect, at the time of each transaction entered into by the person or partnership after March 5, 1996 that either gives rise to the requirement to file the return or that affects the information to be reported in the return, that sufficient information would be available to the person or partnership to comply with section 233.2 or 233.4, as the case may be; and
- the information is filed with the Minister not more than 90 days after it becomes available to the person or partnership.

New section 233.5 applies to information returns required to be filed after April, 1998.

ITA
233.6

New section 233.6 of the Act requires a "specified Canadian entity" (as defined by subsection 233.3(1)) that is beneficially interested in a non-resident trust to file an information return for each taxation year

or fiscal period in which the entity receives a distribution of property from, or is indebted to, the trust, unless the trust is an estate of a deceased person or an "excluded trust".

New subsection 233.6(1) provides that the filing deadline for the information return for a taxation year is the same deadline that applies for the purpose of filing the specified Canadian entity's income tax return for the year under Part I of the Act.

A partnership's information return is required to be filed by the day by which the partnership's return under section 229 of the *Income Tax Regulations* must be filed. If no section 229 return is required, the partnership's information return under section 233.6 must be filed by the day by which the section 229 return would be required to be filed if section 229 applied to the partnership.

New subsection 233.6(2) defines an "excluded trust" to mean:

- an "exempt trust", as described in the commentary on subsection 233.2(1), other than a foreign mutual fund trust described in that commentary,

- a trust in respect of which the entity is already required to file an information return under section 233.2,

- a trust an interest in which the entity is required to report under section 233.3, and

- a trust in respect of which the entity is required to file an information return under section 233.4.

A transitional rule in the coming-into-force provision for section 233.6 provides that for taxation years or fiscal periods ending before 1999, no return is due before April 30, 1998.

ITA
233.7

New section 233.7 of the Act provides that an individual (other than a trust) is not required to file an information return in respect of the

individual's foreign property under any of new sections 233.2, 233.3, 233.4 and 233.6 for a taxation year, if the taxpayer first became a resident of Canada in the year.

New section 233.7 applies to information returns required to be filed after April 30, 1998.

Clause 70

Provision of Information

ITA
241

Section 241 of the Act prohibits the communication of taxpayer information by an official or an authorized person unless specifically authorized by one of the exceptions found in that section.

ITA
241(4)(*d*)

Subparagraph 241(4)(*d*)(vi.1) of the Act is amended to permit the communication of certain taxpayer information to an official of the Department of Natural Resources for the purpose of determining whether an expense is a "Canadian renewable and conservation expense". For further detail, see the commentary on the new definition of that expression in subsection 66.1(6).

This amendment applies on Royal Assent.

Clause 71

Definitions

ITA
248

Section 248 of the Act defines a number of terms which apply for the purposes of the Act, and also sets out various rules relating to the interpretation and application of various provisions of the Act.

Subclause 71(1)

ITA
248(1)

"balance-due day"

Subsection 248(1) of the Act defines an individual's "balance-due day" for a taxation year. It is the day (April 30 of the following year, in the case of a living individual) by which the individual is normally required to pay any balance of taxes payable under Part I for the year.

The expression "balance-due day" is amended so that it now applies in a parallel manner to corporations. Additional references to the definition have, as a consequence, been included in amended subsections 125.4(3), 127.1(1), 127.41(3) and 161(2.2) and new subsection 161(6.2).

This amendment applies to the 1996 and subsequent taxation years.

"exempt income"

The definition "exempt income" applies to money or property that is, because of any provision in Part I of the Act, not included in computing a person's income. The definition is used, for example, in paragraph 18(1)(*c*) of the Act, which provides that no deduction may be taken for expenses or outlays that relate to exempt income.

As a consequence of the new tax treatment of child support amounts, the definition "exempt income" is amended so that it does not include support amounts. This will ensure that expenses incurred in respect of such amounts continue to be deductible even where the amount is a child support amount that is not included in income under Part I of the Act. As well, the reference to "money" in the definition is being deleted, as it is redundant.

These amendments apply after 1996.

"oil or gas well"

The federal government's 1996 budget announced that all oil sands projects, whether of the surface mining type or the "in situ" type, would be treated as mines for capital cost allowance purposes. The definition "oil or gas well" is, therefore, amended to exclude, for the purpose of applying the capital cost allowance provisions to property acquired after March 6, 1996, wells for the extraction of material from a deposit of bituminous sands or oil shales.

This amendment applies after March 6, 1996.

"tar sands"

The 1996 budget announced that all oil sands projects, whether of the surface mining type or the "in situ" type, would be treated as mines for capital cost allowance purposes. The definition "tar sands" is, therefore, amended to include, for the purpose of applying the capital cost allowance provisions to property acquired after March 6, 1996, material extracted by a well from a deposit of bituminous sands or oil shales. In addition, the reference to oil sands has been removed consequential on the introduction of the definition "bituminous sands" in subsection 248(1).

This amendment applies after March 6, 1996.

Subclause 71(2)

"mineral resource"

The definition "mineral resource" is amended to eliminate the phrase "oil sands" consequential on the introduction of the definition "bituminous sands" in subsection 248(1).

This amendment applies after March 6, 1996.

Subclause 71(3)

ITA
248(1)

"bituminous sands"

Subsection 248(1) of the Act is amended to introduce a definition of "bituminous sands". In consequence of this clarification, all references in the Act to "oil sands" are being repealed to eliminate the redundancy of the use of both terms.

This amendment applies after March 6, 1996.

"business limit"

Subsection 248(1) is also amended to introduce the definition "business limit". A corporation's "business limit" for a taxation year is the amount determined under section 125 to be it business limit for the year.

This amendment applies after May 23, 1985, in order that it may apply from that date for the purposes of new paragraphs 87(2)(*o*.1) and 88(1)(*e*.9).

"Canadian field processing"

Subsection 248(1) is also amended to define the expression "Canadian field processing". The expression is used in the definitions "manufacturing or processing" in subsection 125.1(3) of the Act and "qualified property" in subsection 127(9). The expression is also to be used in proposed amendments to Parts XI and XII of the *Income Tax Regulations*.

As a consequence of amendments to section 125.1 of the Act and the Regulations, activities now characterized as "Canadian field processing" will never be treated as "manufacturing or processing" activities that might result in the M & P tax credit or favourable treatment under the capital cost allowance rules. Instead, such activities will result in an increase in a taxpayer's entitlement to the resource allowance under paragraph 20(1)(*v*.1). Depreciable property

acquired in connection with "Canadian field processing" that would otherwise be included in capital cost allowance Class 29, 39 or 43 is now generally to be included in Class 41.

"Canadian field processing" is defined as:

- the processing in Canada of raw natural gas at a field separation and dehydration facility,

- the processing in Canada of raw natural gas at a natural gas processing plant to any stage that is not beyond the stage of natural gas that is acceptable to a common carrier of natural gas,

- the processing in Canada of hydrogen sulphide derived from raw natural gas to any stage that is not beyond the marketable sulphur stage, and

- the processing in Canada of natural gas liquids, at a natural gas processing plant where the input is raw natural gas derived from a natural accumulation of natural gas, to any stage that is not beyond the marketable liquefied petroleum stage or its equivalent.

Two rules of interpretation are relevant for the purposes of the last three processing activities described above. "Raw" gas is not considered to cease to be raw natural gas only because of its processing at a field separation and dehydration facility. Furthermore, the part of any natural gas processing plant devoted primarily to the recovery of ethane is not considered to be part of that plant.

The intent of these rules is to allow most gas processing to be treated as "Canadian field processing", which is to qualify for the resource allowance and not qualify for manufacturing and processing tax treatment. (Currently, gas processing that occurs after gas passes through the inlet separator to a natural gas processing plant does not result in an increase in a taxpayer's entitlement to the resource allowance.) The exceptions are intended to exclude processing at mainline "straddle plants" as well as plants (or parts of plants) that are devoted primarily to the extraction of ethane. Allowance is made in the rule to provide specific exceptions to these rules by regulation. At the present time, it is not anticipated that any such regulations will be required.

In addition, for greater clarity in applying the resource allowance rules, "Canadian field processing" also includes any processing in Canada of crude oil (other than heavy crude oil recovered from an oil or gas well or a tar sands deposit) recovered from a natural accumulation of petroleum to any stage that is not beyond the crude oil stage or its equivalent.

This amendment applies after 1996.

"controlled foreign affiliate"

Subsection 248(1) is also amended by providing a definition of the expression "controlled foreign affiliate" for the purposes of the Act. It is defined in the same manner that the expression is defined under subsection 95(1) of the Act.

The amendment applies after 1995.

"designated insurance property"

The new definition of "designated insurance property", which has the meaning assigned by subsection 138(12) of the Act, is added to subsection 248(1). This definition is relevant for the purposes of the amended definition of "outstanding debts to specified non-residents" in subsection 18(5), subsection 85(1.1), paragraph 115(1)(*b*) and sections 138 and 219 of the Act.

This amendment applies to 1996 and subsequent taxation years.

"registered labour-sponsored venture capital corporation"

Subsection 248(1) is also amended to introduce the definition of "registered labour-sponsored venture capital corporation" for the purposes of the Act. A "registered labour-sponsored venture capital corporation" means a corporation that was registered under subsection 204.81(1), the registration of which has not been revoked. This definition replaces the existing definition of the term in section 204.8.

This amendment applies after 1995.

"specified future tax consequence"

The expression "specified future tax consequence" is introduced in subsection 248(1). The expression is used in paragraphs 87(2)(*oo*) and (*oo*.1) and 88(1)(*e*.8) and (*e*.9), subsections 127(10.2), 127.1(2), 156.1(1.1) and (1.2), 157(5), 161(4), (4.01), (4.1) and (6.2) and 162(11) and Part LIII of the Regulations. For further details, see the commentary on these provisions and Appendix C to these explanatory notes.

A "specified future tax consequence" for a taxation year is defined as

- the consequence of the deduction or exclusion of amounts referred to in paragraph 161(7)(*a*), or

- the consequence of a reduction under subsection 66(12.73) of an amount purported to be renounced by a corporation after the beginning of the year under subsection 66(12.6) or (12.601) because of the application of subsection 66(12.66).

The definition also provides that the consequence of a reduction of an amount purported to be renounced is generally determined as if the purported renunciation would, but for subsection 66(12.73), have been effective. However, this assumption applies to a particular amount purported to have been renounced by a corporation to a person or partnership under subsection 66(12.6) or (12.601) only where

- the purported renunciation occurred in January, February or March of a calendar year,

- the effective date of the purported renunciation was the last day of that preceding calendar year,

- the corporation agreed in that preceding calendar year to issue a flow-though share to the person or partnership,

- the particular amount does not exceed the amount, if any, by which the consideration for which the share is to be issued exceeds the total of all other amounts purported by the corporation to have been renounced under subsection 66(12.6) or (12.601) in respect of that consideration,

- paragraphs 66(12.66)(*c*) (consideration required to be paid in money) and (*d*) (arm's length requirement) are satisfied with respect to the purported renunciation, and

- the form prescribed for the purposes of subsection 66(12.7) in respect of the purported renunciation is filed before May of the calendar year.

This amendment applies to the 1996 and subsequent taxation years. For earlier taxation years, there are considered to be no specified future tax consequences.

Subclause 71(4)

ITA
248(25)

Subsection 248(25) of the Act provides that a person or partnership is "beneficially interested" in a trust if that person has an absolute or conditional right to the income or capital of the trust, either directly or indirectly through one or more other trusts.

Subsection 248(25) is amended so that the expression "beneficially interested" is not provided with a comprehensive definition. A person or partnership "beneficially interested" in a trust now includes, in addition any person or partnership explicitly referred to, any other person or partnership otherwise regarded as "beneficially interested" in the trust.

This amendment applies after 1996.

Clause 72

Adjusted Cost Base

ITAR
26(9.4)

Subsection 26(9.4) of the *Income Tax Application Rules* provides rules for the purposes of computing a taxpayer's adjusted cost base of a partnership interest where the taxpayer was a member of the

partnership on December 31, 1971 and throughout the subsequent period ending at the time that the adjusted cost base is to be calculated.

Paragraph 26(9.4)(*b*) of the Rules is amended so that paragraph 12(1)(*z*.5) of the Act is ignored for this purpose. This amendment conforms to a similar amendment to clause 53(2)(*c*)(i)(B), as described in the commentary above.

This amendment applies for the purposes of computing adjusted cost bases of partnership interests after 1996.

Clause 73

Joint Exploration Corporations

ITAR
29(6) to (8)

Subsections 29(6) to (8) of the Rules allow renunciations by joint exploration corporations of certain pre-1972 resource expenses.

Subsection 29(6) to (8) of the Rules are being repealed, in conjunction with the repeal of the rules for joint exploration corporations in subsections 66(10) to (10.3) of the Act.

This amendment applies to renunciations after March 5, 1996, subject to the same grandfathering rules as are described in the commentary on the repeal of subsections 66(10) to (10.3) of the Act.

Clause 74

Scientific Research and Experimental Development

An Act to Amend the Income Tax Act, S.C. 1994, c.8
4(5)

Expenses relating to the acquisition or rental of buildings were made generally ineligible for the SR&ED tax incentives after 1987.

However, transitional relief was provided for certain buildings and leasehold interests acquired before 1990.

The 1996 federal budget announced the termination of this transitional relief. The amendments to the original coming-into-force of the 1987 exclusions give effect to this announcement by providing that the transitional relief is not available for taxation years that begin after March 6, 1996.

Clause 75

Conditional Amendments

The amending legislation contains a number of amendments that are conditional on the passing of another bill.

A conditional amendment to 66(12.66) of the Act is explained in the commentary on that provision.

The other bill includes an amendment to subsection 115(1) of the Act which, among other things, renumbers the subparagraphs in paragraph 115(1)(*b*). Consequently, subparagraph 115(1)(*b*)(ii.1) will become subparagraph 115(1)(*b*)(iii) if that bill is passed. This conditional amendment ensures that the changes to subparagraph 115(1)(*b*)(ii.1) will be reflected in renumbered subparagraph 115(1)(*b*)(iii).

A conditional amendment to paragraph 219(1)(*k*) of the Act is consequential to the introduction of new paragraph 12(1)(*z*.5) of the Act. The amendment to paragraph 219(1)(*k*) ensures the appropriate measurement of the amount subject to tax under Part XIV of the Act, where a corporation has included an amount in income under new paragraph 12(1)(*z*.5).

APPENDIX A

DRAFT INCOME TAX REGULATIONS AND EXPLANATORY NOTES

Resource allowance and related matters

1.(1) Subparagraph 1100(1)(*w*)(i) of the *Income Tax Regulations* is replaced by the following:

(i) the taxpayer's income for the year from the mine determined without reference to paragraph 12(1)(*z*.5) of the Act and before making any deduction under this paragraph, paragraph (*x*), (*y*) or (*ya*), paragraph 20(1)(*v*.1) of the Act, section 65, 66, 66.1, 66.2 or 66.7 of the Act or section 29 of the *Income Tax Application Rules*, and 5

(2) Subparagraph 1100(1)(*x*)(i) of the Regulations is replaced by the following: 10

(i) the taxpayer's income for the year from the mines determined without reference to paragraph 12(1)(*z*.5) of the Act and before making any deduction under this paragraph, paragraph (*ya*), paragraph 20(1)(*v*.1) of the Act, section 65, 66, 66.1, 66.2 or 66.7 of the Act or section 29 of the *Income Tax Application Rules*, and 15

(3) Subparagraph 1100(1)(*y*)(i) of the Regulations is replaced by the following:

(i) the taxpayer's income for the year from the mine determined without reference to paragraph 12(1)(*z*.5) of the Act and before making any deduction under this paragraph, paragraph (*x*) or (*ya*), paragraph 20(1)(*v*.1) of the Act, section 65, 66, 66.1, 66.2 or 66.7 of the Act or section 29 of the *Income Tax Application Rules*, and 20

(4) Subparagraph 1100(1)(*ya*)(i) of the Regulations is replaced by the following:

(i) the taxpayer's income for the year from the mines determined without reference to paragraph 12(1)(*z*.5) of the Act and before making any deduction under this paragraph, paragraph 20(1)(*v*.1) 25

of the Act, section 65, 66, 66.1, 66.2 or 66.7 of the Act or section 29 of the *Income Tax Application Rules*, and

2. (1) Paragraph 1102(1)(*a*) of the Regulations is replaced by the following:

(*a*) the cost of which would be deductible in computing the taxpayer's income if the Act were read without reference to sections 66 to 66.4 of the Act; 5

(2) Section 1102 of the Regulations is amended by adding the following after subsection (14.1):

Townsite Costs 10

(14.2) For the purpose of paragraph 13(7.5)(*a*) of the Act, a property is prescribed in respect of a taxpayer where the property would, if it had been acquired by the taxpayer, be property included in Class 10 in Schedule II because of paragraph (*l*) of that Class.

Surface Construction and Bridges 15

(14.3) For the purpose of paragraph 13(7.5)(*b*) of the Act, prescribed property is any of

(*a*) a road (other than a specified temporary access road), sidewalk, airplane runway, parking area, storage area or similar surface construction, 20

(*b*) a bridge, and

(*c*) a property that is ancillary to any of the properties described in paragraph (*a*) or (*b*).

(3) Subsection 1102(18) of the Regulations and the heading before it are repealed. 25

3. (1) Subsection 1104(2) of the Regulations is amended by adding the following definitions in alphabetical order:

"coal mine operator"

"coal mine operator" means a person who undertakes all or substantially all of the activities involved in the production of coal from a resource;

"specified temporary access road"
«------------------------» 5

"specified temporary access road" means

(*a*) a temporary access road to an oil or gas well in Canada, and

(*b*) a temporary access road the cost of which would, if the definition "Canadian exploration expense" in subsection 66.1(6) of the Act were read without reference to paragraph (*l*) of that definition, be a Canadian exploration expense because of paragraph (*f*) or (*g*) of that definition; 10

(2) Subsection 1104(6.1) of the Regulations is replaced by the following: 15

(6.1) Notwithstanding subsections (5) and (6),

(*a*) for the purposes of paragraphs 1100(1)(*w*) to (*ya*), subsections 1101(4a) to (4d) and Classes 28 and 41 in Schedule II, "income from a mine", or any expression referring to a taxpayer's income from a mine, does not include income that can reasonably be attributed to a service rendered by the taxpayer (other than a service rendered by the taxpayer as a coal mine operator); and 20

(*b*) for the purpose of Class 10 in Schedule II, "income from a mine" does not include income that can reasonably be attributed to a service rendered by the taxpayer (other than a service that is the processing of ore or that is rendered by the taxpayer as a coal mine operator). 25

(3) Paragraph 1104(9)(*g*) of the Regulations is replaced by the following:

(*g*) producing industrial minerals, 30

(4) Paragraphs 1104(9)(*i*) and (*j*) of the Regulations are replaced by the following:

(*i*) processing natural gas as part of the business of selling or distributing gas in the course of operating a public utility,

(*j*) processing heavy crude oil recovered from a natural reservoir in Canada to a stage that is not beyond the crude oil stage or its equivalent, or 5

(*k*) Canadian field processing.

4. (1) The portion of subparagraph 1204(1)(*b*)(i) of the Regulations before clause (A) is replaced by the following: 10

(i) the production of petroleum, natural gas, related hydrocarbons or sulphur from

(2) Paragraph 1204(1)(*b*) of the Regulations is amended by striking out the word "and" at the end of subparagraph (iv), by adding the word "and" at the end of subparagraph (v) and by adding the following after subparagraph (v): 15

(vi) Canadian field processing,

(3) Paragraph 1204(3)(*a*) of the Regulations is replaced by the following:

(*a*) any income or loss derived from transporting, transmitting or processing (other than processing described in clause (1)(*b*)(ii)(C), (iii)(C) or (iv)(C) or subparagraph (1)(*b*)(v) or (vi)) petroleum, natural gas or related hydrocarbons or sulphur from a natural accumulation of petroleum or natural gas; 20

(4) Paragraph 1204(3)(*c*) of the Regulations is replaced by the following: 25

(*c*) any income or loss that can reasonably be attributable to a service rendered by the taxpayer (other than processing described in subparagraph (1)(*b*)(iii), (iv), (v) or (vi) or activities carried out by the taxpayer as a coal mine operator). 30

5. (1) The portion of paragraph (*a*) of the definition "resource activity" in subsection 1206(1) of the Regulations before subparagraph (i) is replaced by the following:

(*a*) the production by the taxpayer of petroleum, natural gas, related hydrocarbons or sulphur from 5

(2) The definition "resource activity" in subsection 1206(1) of the Regulations is amended by adding the following after paragraph (*c*):

(*c*.1) Canadian field processing carried on by the taxpayer,

(3) Clause (*j*)(i)(A) of the definition "resource activity" in subsection 1206(1) of the Regulations is replaced by the following: 10

(A) is the transporting, transmitting or processing (other than processing described in subparagraph (*b*)(iii), paragraph (*c*) or (*c*.1) or subparagraph (*d*)(iii)) of petroleum, natural gas or related hydrocarbons or of sulphur, or

(4) Subsection 1206(1) of the Regulations is amended by adding the following in alphabetical order: 15

"coal mine operator"

"coal mine operator" means a person who undertakes all or substantially all of the activities involved in the production of coal from a resource; 20

"specified royalty"

"specified royalty" means a royalty created after ANNOUNCEMENT DATE (otherwise than pursuant to an agreement in writing made before on or before that date) where

(*a*) the cost of the royalty was a Canadian development expense, and 25

(*b*) the royalty was created as part of a transaction or event or series of transactions or events as a consequence of which depreciable property was acquired at a capital cost that was less than its fair market value (determined without regard to the royalty);

6. (1) The portion of subparagraph (*c*)(i) before clause (A) in the description of A in subsection 1210(2) of the Regulations is replaced by the following:

(i) each amount deducted in computing the taxpayer's income for the year in respect of a rental or royalty paid or payable by the taxpayer (other than an amount prescribed by section 1211, an amount that is a production royalty and an amount paid or payable in respect of a specified royalty) computed by reference to the amount or value of petroleum, natural gas or related hydrocarbons 5

(2) The description of C in subsection 1210(2) of the Regulations is replaced by the following: 10

C is the amount, if any, by which the total of

(*a*) the total of all amounts each of which is an amount included in the taxpayer's gross resource profits for the year as a rental or royalty (other than a production royalty or a specified royalty) computed by reference to the amount or value of petroleum, natural gas or related hydrocarbons produced from 15

(i) a natural accumulation (other than a resource) of petroleum or natural gas in Canada or an oil or gas well in Canada, or

(ii) a resource that is a bituminous sands deposit or oil shale deposit, and 20

(*b*) 1/2 of all amounts included in computing the taxpayer's gross resource profits for the year in respect of specified royalties

exceeds

(*c*) where the year ends after March 6, 1996, the total of all outlays and expenses that were made or incurred in respect of the total described in paragraph (*a*) to the extent that the outlays and expenses were deducted in computing the taxpayer's gross resource profits for the year. 25

7. Part XII of the Regulations is amended by adding the following after section 1210: 30

1210.1 For the purpose of paragraph 12(1)(*z*.5) of the Act, a taxpayer's prescribed resource loss for a taxation year is the amount determined by the formula

A - B

where 5

A is the total of all amounts each of which is a Canadian exploration and development overhead expense made or incurred by the taxpayer in the year, other than an amount included therein because of subsection 21(2) or (4) of the Act; and

B is the taxpayer's adjusted resource profits for the year (as defined by subsection 1210(2)). 10

8. The definition "adjusted business income" in subsection 5203(1) of the Regulations is amended by striking out the word "and" at the end of paragraph (*b*), by adding the word "and" after paragraph (*c*) and by adding the following after paragraph (*c*): 15

(*d*) all amounts each of which is included under paragraph 12(1)(*z*.5) in computing the taxpayer's income for the year;

9. (1) Subparagraph (*i*)(iv) of Class 8 of Schedule II to the Regulations is replaced by the following:

(iv) an oil or gas well, 20

(2) Subparagraph (*i*)(vi) of Class 8 of Schedule II to the Regulations is replaced by the following:

(vi) a specified temporary access road of the taxpayer,

10. Paragraph (*c*) of Class 17 of Schedule II to the Regulations is replaced by the following: 25

(*c*) a road (other than a specified temporary access road of the taxpayer), sidewalk, airplane runway, parking area, storage area or similar surface construction.

11. (1) The portion of Class 29 of Schedule II of the Regulations before paragraph (*a*) is replaced by the following:

CLASS 29

Property not included in Class 41 because of paragraph (*c*) or (*d*) of that Class that would otherwise be included in another class in this Schedule 5

(2) The portion of subparagraph (*a*)(ii) of Class 29 of Schedule II of the Regulations before clause (A) is replaced by the following:

(ii) to be leased, in the ordinary course of carrying on a business in Canada of the taxpayer, to a lessee who can reasonably be 10 expected to use, directly or indirectly, the property in Canada primarily in Canadian field processing carried on by the lessee or the manufacturing or processing by the lessee of goods for sale or lease, if the taxpayer is a corporation whose principal business is

12. Class 41 of Schedule II to the Regulations is amended by 15 striking out the word "or" at the end of paragraph (*a*) and by adding the following after paragraph (*b*):

(*c*) acquired by the taxpayer after May 8, 1972, to be used directly or indirectly by the taxpayer in Canada primarily in Canadian field processing, where the property would be included in Class 29 if 20

(i) Class 29 were read without reference to subparagraphs (*b*)(iii) and (v) and paragraph (*c*) of that Class,

(ii) subsection 1104(9) were read without reference to paragraph (*k*) of that subsection, and

(iii) this Schedule were read without reference to this Class, 25 Class 39 and Class 43; or

(*d*) acquired by the taxpayer after ANNOUNCEMENT DATE (otherwise than pursuant to an agreement in writing made before [ANNOUNCEMENT DATE + 1]) to be leased, in the ordinary course of carrying on a business in Canada of the taxpayer, to a lessee who 30 can reasonably be expected to use, directly or indirectly, the property

in Canada primarily in Canadian field processing carried on by the lessee, where the property would be included in Class 29 if

(i) Class 29 were read without reference to subparagraphs (*b*)(iii) and (v) and paragraph (*c*) of that Class, and

(ii) this Schedule were read without reference to this Class, Class 39 and Class 43. 5

13. (1) Section 1, subsections 3(3) and (4), subsections 4(1) to (3), subsections 5(1) to (3) and sections 7, 8, 11 and 12 apply to taxation years that begin after 1996.

(2) Subsection 2(1) and section 6 apply to taxation years that end after March 6, 1996. 10

(3) Subsection 2(2), the definition "specified temporary access road" in subsection 1104(2) of the Regulations, as enacted by subsection 3(1), and subsection 5(4) apply after March 6, 1996 except that, with respect to a royalty created after March 6, 1996 and before [ANNOUNCEMENT DATE + 1] (or after March 6, 1996 and before 1998 pursuant to an agreement in writing made on or before ANNOUNCEMENT DATE) where any of the parties to the royalty so elect in writing filed with the Minister of National Revenue before July 1998, the definition "specified royalty" in subsection 1206(1) of the Regulations, as enacted by subsection 5(4), shall be read as follows in respect of the royalty: 15 20

"specified royalty" means a royalty (other than a production royalty) created after March 6, 1996 (otherwise than pursuant to an agreement in writing made before March 7, 1996) where 25

(*a*) any amount paid or payable to the holder of the royalty because of the holder's interest in the royalty is calculated with reference to any expense, or

(*b*) an arrangement involving the reimbursement of, contribution to or allowance for, any expense has been made after March 6, 1996 and it is reasonable to consider that one of the reasons for the arrangement is to avoid the application of paragraph (*a*) in respect of the royalty; 30

(4) Subsection 2(3) applies to payments required to be made under the terms of contracts made after March 6, 1996.

(5) Subsections 3(2) and 4(4) apply to taxation years that begin after March 6, 1996.

(6) Sections 9 and 10 apply to property acquired after March 6, 1996. 5

Explanatory Notes

ITR
1100(1)(*w*), (*x*), (*y*) and (*ya*)

Paragraphs 1100(1)(*w*) to (*ya*) of the Regulations allow an accelerated capital cost allowance, up to the amount of specified income from one or more mines, with respect to certain mining assets. For this purpose, a taxpayer's income is computed without reference to the resource allowance and a number of other provisions.

Paragraphs 1100(1)(*w*) to (*ya*) are amended to ensure that a taxpayer's income from a mine is also computed without reference to the "negative" resource allowance provided under new paragraph 12(1)(*z*.5) of the Act. For further detail on paragraph 12(1)(*z*.5), see the commentary on that paragraph and on new section 1210.1 of the Regulations.

These amendments apply to taxation years that begin after 1996.

ITR
1102(1)(*a*)

Subsection 1102(1) of the Regulations provides that certain properties are excluded as depreciable properties under Schedule II to the Regulations. Under paragraph 1102(1)(*a*), a taxpayer's property is excluded for this purpose if its cost is deductible in computing the taxpayer's income.

Paragraph 1102(1)(*a*) is amended to provide that it does not apply to a property the cost of which is deductible under any of sections 66 to 66.4 of the Act. This amendment is made in order to resolve any circularity between the resource provisions and the depreciable property provisions. In this regard, it is noted that there are a number of references in these sections to depreciable property, including new references in the amended definitions "Canadian exploration expense" and "Canadian development expense" in subsections 66.1(6) and 66.2(5) of the Act. The amendment to paragraph 1102(1)(*a*) ensures that the determination of whether property is depreciable property is generally made before determining whether the cost the property is eligible for deduction under any of sections 66 to 66.4 of the Act.

A further proposed amendment to subsection 1102(1) is contained in Appendix E to these explanatory notes.

These amendments apply to taxation years that end after March 6, 1996.

ITR
1102(14.2), (14.3) and (18)

New subsection 1102(14.2) of the Regulations prescribes property for the purpose of the rules relating to depreciable property in paragraph 13(7.5)(*a*) of the Act. The properties to be prescribed after March 6, 1996 for this purpose are those specified townsite properties in respect of a mine that were previously eligible under subsection 1102(18) for depreciable property treatment.

Subsection 1102(14.3) prescribes property for the purpose of the rules relating to depreciable property in paragraph 13(7.5)(*b*) of the Act. The following properties are to be prescribed after March 6, 1996 for this purpose:

- a road (other than a "specified temporary access road" now defined in subsection 1104(2)), sidewalk, airplane runway, parking area, storage area or similar surface construction,

- a bridge, and

- a property that is ancillary to any of the above properties.

Subsection 1102(18) is repealed as a consequence of the introduction of paragraph 13(7.5)(*a*) of the Act. The repeal of subsection 1102(18) applies in respect of payments required to be made under the terms of contracts made after March 6, 1996.

ITR
1104(2)

"coal mine operator"

A "coal mine operator" is defined as a person who carries out all or substantially all of the activities involved in the production of coal

from a mineral resource in Canada. This definition is relevant for the purposes of the amendment to subsection 1104(6.1).

In this context, the activities envisaged are as follows:

- the long term dedication of management and qualified employees to carry out mining activities,

- the supply and maintenance of capital equipment,

- the removal of overburden material, the recovery and delivery of coal and the reclamation of disturbed lands,

- the coordination and negotiation for supply of materials,

- exploration and development activities in respect of coal,

- development and coordination of a coal mine plan, and

- regulatory compliance regarding licences, permits, the environment, reclamation and safety and health.

ITR
1104(2)

"specified temporary access road"

Subsection 1104(2) of the Regulations is amended to define the expression "specified temporary access road". The expression is used in new subsection 1102(14.3), as well as in amendments to Classes 8 and 17 of Schedule II to the Regulations. The intent of the special rule for such roads is to not preclude the costs of temporary access roads in the oil and gas and mining sectors from qualifying as a Canadian exploration expense (CEE) or Canadian development expense (CDE). Note, in this regard, the explicit exclusions with respect to depreciable property provided under new paragraph (*l*) of the CEE definition in subsection 66.1(6) of the Act and under new paragraph (*j*) of the CDE definition in subsection 66.2(5) of the Act.

This amendment applies after March 6, 1996.

ITR
1104(6.1)

Subsections 1104(5) and (6) of the Regulations provide that, for specified purposes, the expression "income from a mine" includes income from listed activities. The definition is primarily relevant for the purpose of determining the capital cost allowance to which taxpayers engaged in mining activities are entitled. Taxpayers who operate mines are generally entitled to capital cost allowance of up to the amount of income from each eligible mine.

Subsection 1104(6.1) provides that, for these purposes, a taxpayer's mining income does not include income that can reasonably be attributed to a service rendered by the taxpayer. The only current exception to this rule applies for the purpose of Class 10. This exception allows those who process ore as a service to others access to the higher capital cost allowance rates provided for depreciable property under Class 10.

Subsection 1104(6.1) is amended so that an exception is also provided with respect to services rendered by a taxpayer as a "coal mine operator", as defined in subsection 1104(2).

Subsection 1104(6.1) is also amended so that the rule also applies for the purposes of Class 41, as a consequence of proposed paragraph (*a*.1) of Class 41 set out in Appendix D to these explanatory notes.

This amendment applies to taxation years that begin after March 6, 1996.

ITR
1104(9)

Subsection 1104(9) of the Regulations defines the expression "manufacturing or processing" for the purposes of Class 29 in Schedule II to the Regulations. Because of the wording of Classes 39 and 43, the definition is also relevant is determining whether property is included in the latter classes.

The definition is amended so that "Canadian field processing" is excluded from "manufacturing or processing" for this purpose.

"Canadian field processing" is newly defined in subsection 248(1) of the Act. For further detail, see the commentary on the new definition.

This amendment applies to taxation years that begin after 1996.

ITR
1204(1)(*b*)

Subsection 1204(1) of the Regulations defines the expression "gross resource profits", which is relevant for the purposes of subsection 1204(1.1) (under which resource profits are determined) and section 1210 (under which adjusted resource profits are determined). Resource profits are relevant for the purposes of computing depletion deductions. Adjusted resource profits are relevant for the purposes of computing the resource allowance.

Paragraph 1204(1)(*b*) is amended so that income from sulphur produced from raw natural gas is included in computing gross resource profits.

Subparagraph 1204(1)(*b*)(vi) is introduced so that income from "Canadian field processing", in particular income from specified processing at natural gas processing plants, is included in the computation of gross resource profits. For further detail, see the commentary on the new definition "Canadian field processing" in subsection 248(1) of the Act.

These amendments apply to taxation years that begin after 1996.

ITR
1204(3)(*a*)

Paragraph 1204(3)(*a*) of the Regulations provides that a taxpayer's income from production does not include income from processing petroleum, natural gas or related hydrocarbon, with the exception of specified processing.

Paragraph 1204(3)(*a*) is amended so that "Canadian field processing", as newly defined in subsection 248(1) of the Act, is likewise excepted from the application of paragraph 1204(3)(*a*).

This amendment applies to taxation years that begin after 1996.

ITR
1204(3)(*c*)

Paragraph 1204(3)(*c*) of the Regulations provides that resource profits do not include any income or loss that is reasonably attributed to a service rendered by a taxpayer, except for the processing of ore.

Paragraph 1204(3)(*c*) is amended so that a service rendered by a taxpayer as a "coal mine operator", as defined by subsection 1206(1), is likewise excepted. This amendment is consistent with the amendment to subsection 1104(6.1), relating to the determination of mining income.

This amendment applies to taxation years that begin after March 6, 1996.

ITR
1206(1)

"resource activity"

The expression "resource activity", defined in subsection 1206(1) of the Regulations, is relevant for the purposes of subsections 1210(1.2) and 1210(2) of the Regulations. Under those subsections, the general rule is that a taxpayer's deductions for a taxation year that relate to a "resource activity" must be deducted in computing the taxpayer's resource profits and adjusted resource profits.

The definition "resource activity" is amended so that "Canadian field processing" carried on by a taxpayer is now included as a "resource activity". This is strictly consequential on the introduction of subparagraph 1204(1)(*b*)(vi).

This amendment applies to taxation years that begin after 1996.

ITR
1206(1)

"coal mine operator"

A "coal mine operator" is defined as a person who carries out all or substantially all of the activities involved in the production of coal

from a mineral resource in Canada. For further detail, see the commentary on the definition of the same expression in subsection 1104(2) and the commentary on amended paragraph 1204(3)(*c*).

ITR
1206(1)

"specified royalty"

Subsection 1206(1) of the Regulations is being amended to introduce the expression "specified royalty". (This amendment replaces a proposed amendment released on March 6, 1996, that would have introduced the expression "specified net royalty".)

A "specified royalty" is defined as a royalty created after ANNOUNCEMENT DATE (otherwise than pursuant to an agreement in writing made before [ANNOUNCEMENT DATE + 1]) where

- the cost of the royalty was a Canadian development expense, and

- the royalty was created as part of a transaction or event or series of transactions or events as a consequence of which depreciable property was acquired at a capital cost that was less than its fair market value (determined without regard to the royalty).

Under proposed amendments to subsection 1210(2), payments made by a taxpayer under a "specified royalty" result in a reduction of the taxpayer's "adjusted resource profits" and, as a consequence, the taxpayer's resource allowance. However, only 50% of payments received by a taxpayer under a "specified royalty" are included in computing the taxpayer's adjusted resource profits.

The impetus for these proposed amendments is that the existing resource allowance rules have given rise to the opportunity to create certain royalties (especially net profit interests), which can be used to significantly increase the overall resource allowance that is available. By carving out a net profit interest from a working interest, the holder of the working interest can substantially decrease the amount paid for depreciable properties associated with the working interest. As a consequence, the amount of the resource profits that qualify for the resource allowance can be increased because of overall lower

resulting amounts of capital cost allowance (which does reduce adjusted resource profits) and overall higher amounts of CDE (which generally does not reduce adjusted resource profits). Where the cost of a royalty is COGPE (rather than CDE) and is consequently not treated as a "specified royalty", there is not a concern in this context because the rate of write-off for COGPE (10%) tends to be significantly less than the rate of write-off with respect to depreciable properties in the oil and gas sector.

This amendment applies after March 6, 1996. However, with respect to a royalty created after March 6, 1996 and before ANNOUNCEMENT DATE (or after March 6, 1996 and before 1998 pursuant to an agreement in writing made before ANNOUNCEMENT DATE) where any of the parties to the royalty so elect in writing filed with the Minister of National Revenue before July 1998, the definition "specified royalty" is defined by the words that were used to define the expression "specified net royalty", referred to above.

ITR
1210(2)

Subsection 1210(2) of the Regulations defines the expression "adjusted resource profits", on which the resource allowance is based under subsection 1210(1). Subsection 1210(2) is amended to provide for the treatment of "specified royalties" that is explained in the commentary on the new definition "specified royalty" in subsection 1206(1).

This amendment applies to taxation years that end after March 6, 1996.

ITR
1210.1

New section 1210.1 of the Regulations prescribes a taxpayer's resource loss for a taxation year for the purposes of paragraph 12(1)(*z*.5) of the Act. Under paragraph 12(1)(*z*.5) of the Act, 25% of the prescribed loss is added in computing a taxpayer's income for the year.

In conjunction with paragraph 12(1)(*z*.5) of the Act, the purpose of this provision is to provide symmetrical treatment for a taxpayer with

respect to the taxpayer's "adjusted resource profits" and the taxpayer's losses from resource activities. Before taking into consideration adjustments for Canadian exploration and development overhead expenses (CEDOE) and earned depletion, 25% of a taxpayer's adjusted resource profits for a taxation year can be deducted as the taxpayer's resource allowance for the year. Symmetrical treatment requires that 25% of any "negative" amount of such adjusted resource profits be added in computing the taxpayer's income for the year.

More specifically, the prescribed resource loss of a taxpayer for a taxation year is determined as follows:

- ADD the CEDOE incurred by the taxpayer in the year, other than capitalized interest included because of subsection 21(2) or (4) of the Act, and

- SUBTRACT the adjusted resource profits of the taxpayer for the year.

A taxpayer's prescribed resource loss for a taxation year will only be a positive amount in the event that its adjusted resource profits are negative (as contemplated by subsection 1210(2)) or a positive amount that is less than its CEDOE for the year. Note that, in the event that the formula provided under new subsection 1210(2) would otherwise result in the calculation of a negative number, the amount determined under the formula is nil because of the operation of section 257 of the Act.

This amendment applies to taxation years that begin after 1996.

ITR
5203

A corporation's manufacturing and processing tax credit is based, in part, on the corporation's "adjusted business income". A corporation's adjusted business income is reduced to reflect its "Canadian resource profits" and "resource profits".

The definition "adjusted business income" in section 5203, which applies only for taxpayers that engage in resource activities, is amended to ensure that the taxpayer's income under

paragraph 12(1)(*z*.5) of the Act is disregarded for this purpose. This amendment is strictly consequential on the introduction of that paragraph.

This amendment applies to taxation years that begin after 1996.

ITR
Schedule II
Class 8

Class 8 of Schedule II to the Regulations describes property that is eligible for a 20% write-off rate. Paragraph (*i*) of that class includes tangible property that is not included in any other class, other than a number of listed exclusions.

Paragraph (*i*) of Class 8 is amended to ensure that roads are not included in Class 8. The costs of temporary access roads built by a taxpayer to an oil and gas well in Canada (and similar temporary mining roads) are generally classified as Canadian exploration expenses or Canadian development expenses. Such an access road is referred to as a "specified temporary access road", which is now defined in subsection 1104(2). Other roads are included in Class 17, except for forestry and mining roads that are included in other classes. For further details, see the commentary on new subsection 13(7.5) of the Act.

This amendment applies to property acquired after March 6, 1996.

ITR
Schedule II
Class 17

Class 17 of Schedule II to the Regulations describes property that is eligible for an 8% write-off rate. Roads not classified elsewhere (i.e., forestry or mining roads in Classes 15 or 41) are included in Class 17.

Class 17 is amended so that it does not extend to specified temporary access roads, as defined in subsection 1104(2). Expenditures of this nature qualify as Canadian exploration expense or Canadian

development expense under subsections 66.1(6) and 66.2(5) of the Act. For further details, see the commentary on new subsection 13(7.5) of the Act.

This amendment applies to property acquired after March 6, 1996.

ITR
Schedule II
Class 29

Schedule II to the Regulations contains three primary classes of property for taxpayers who engage in "manufacturing or processing", as defined in subsection 1104(9). These classes are:

- Class 29, which generally applies to property acquired before 1988,

- Class 39, which generally applies to property acquired after 1987 and before February 26, 1992, and

- Class 43, which applies to property acquired after February 25, 1992.

Class 29 is amended so that property described in paragraph (*c*) or (*d*) of Class 41 is no longer included in Class 29 and, as a consequence, is also not included in Class 39 or 43.

Subparagraph (*a*)(ii) of Class 29 is amended so that the exclusion of "Canadian field processing" from the definition "manufacturing and processing" in subsection 1104(9) will not by itself result in a reclassification of a lessor's manufacturing and processing properties under Class 29, 41 or 43. Note, however, that lessors are specifically dealt with in new paragraph (*d*) of Class 41.

These amendments apply to taxation years that begin after 1996.

ITR
Schedule II
Class 41

Paragraphs (*c*) and (*d*) of Class 41 are introduced so that specified property that pertains to "Canadian field processing", as defined in

subsection 248(1) of the Act, will now be treated as Class 41 property rather than property under Class 29, 39 or 43.

More specifically, under new paragraph (*c*) of Class 41, all property acquired by a taxpayer after May 8, 1972 to be used directly or indirectly by the taxpayer primarily in "Canadian field processing" is Class 41 property, where the property is described in paragraph (*b*) of Class 29 and is not a powered industrial lift truck, a portable tool, data processing equipment or systems software so described. "Canadian field processing" is, for this purpose, now defined in subsection 248(1) of the Act to include most processing of natural gas.

New paragraph (*d*) of Class 41 likewise includes all such property acquired by a taxpayer after ANNOUNCEMENT DATE (otherwise than pursuant to an agreement entered into before [ANNOUNCEMENT DATE + 1] to be leased, in the ordinary course of carrying on a business in Canada of the taxpayer, to a lessee who can reasonably be expected to use, directly or indirectly, the property in Canada primarily in "Canadian field processing" carried on by the lessee.

Property included in paragraph (*c*) or (*d*) cannot be included in Class 29, 39 or 43 because of one of the amendments to Class 29, as described in the commentary above.

New paragraphs (*c*) and (*d*) of Class 41 apply to taxation years that begin after 1996. Subsection 13(5) of the Act is relevant in the event that there is a reclassification of property as of the beginning of a taxpayer’s first such taxation year.

It should be noted that further proposed amendments to Class 41 are contained in Appendix D to these explanatory notes.

APPENDIX B

DRAFT *INCOME TAX REGULATIONS* AND EXPLANATORY NOTES

Labour-sponsored venture capital corporations

1. The portion of paragraph 5100(2)(*b*) of the Income Tax Regulations before subparagraph (i) is replaced by the following:

(*b*) a debt obligation of an eligible corporation (other than a prescribed venture capital corporation described in section 6700), that does not by its terms or any agreement related to the obligation restrict the corporation from incurring other debts and that is 5

2. Paragraph 6700(*d*) of the Regulations is replaced by the following:

(*d*) a corporation that is at that time a registered labour-sponsored venture capital corporation; or 10

3. Paragraph 6701(*d*) of the Regulations is replaced by the following:

(*d*) a registered labour-sponsored venture capital corporation;

4. Section 6706 of the Regulations is replaced by the following:

6706. For the purpose of clause 204.81(1)(*c*)(v)(F) of the Act, a corporation may redeem a Class A share of its capital stock where the corporation withholds an amount in respect of the redemption in accordance with Part XII.5 of the Act. 15

5. (1) Section 1 applies to debt obligations issued after ANNOUNCEMENT DATE, other than debt obligations that were required to be issued pursuant to agreements in writing made on or before that date. 20

(2) Sections 2 and 3 apply after 1995.

(3) Section 4 applies to redemptions that occur after 1997.

Explanatory Notes

ITR
5100(2)(*b*)

Part LI of the Regulations contains rules to allow investments in small business properties by RRSPs, RRIFs and DPSPs and to permit registered plans to exceed the 20% limit (not exceeding 40% of the total property) on foreign property by $3 for each $1 of qualified investment in a "small business property" without incurring tax. "A small business security", which is considered to be a small business property for the purpose of the "3 for 1" rule above, is defined under subsection 5100(2) of the Regulations and includes shares and certain unsecured or subordinated debt issued by eligible corporations.

Paragraph (*b*) of the definition "small business security" in subsection 5100(2) is amended to exclude from the definition unsecured or subordinated debt issued by eligible corporations that are prescribed labour-sponsored venture capital corporations in Part LVII of the Regulations.

This amendment applies to debt obligations issued after ANNOUNCEMENT DATE, other than debt obligations that were required to be issued pursuant to agreements in writing made on or before that date.

ITR
6700(*d*) and 6701(*d*)

Sections 6700 and 6701 of the Regulations provide a list of "prescribed venture capital corporations" and "prescribed labour-sponsored venture capital corporations" for the purposes of certain provisions of the Act. Under paragraphs 6700(*d*) and 6701(*d*), there is included a "registered labour-sponsored venture capital corporation" within the meaning assigned by section 204.8 of the Act. As set out above, the latter expression is now defined in subsection 248(1) of the Act rather than section 204.8.

Paragraphs 6700(*d*) and 6701(*d*) are amended to eliminate references to section 204.8 of the Act, strictly as a consequence of the addition of the definition "registered labour-sponsored venture capital corporation" to subsection 248(1) of the Act.

ITR
6706

Existing clause 204.81(1)(*c*)(v)(F) of the Act provides that a registered LSVCC may redeem a Class A share if the holder of the share satisfies prescribed conditions. For this purpose, section 6706 of the Regulations essentially provides that a registered LSVCC may redeem a share if the maximum tax credit associated with that share is repaid by the holder.

Section 6706 is amended to provide that a registered LSVCC may redeem Class A shares in the capital stock of the corporation if it withholds an amount from the proceeds of the redemption in accordance with new Part XII.5 of the Act.

This amendment applies to redemptions of shares that occur after 1997.

APPENDIX C

DRAFT *INCOME TAX REGULATIONS* AND EXPLANATORY NOTES

Flow-Through Share Rules

1. Section 5300 of the *Income Tax Regulations* is replaced by the following:

5300. For the purposes of subsections 155(2), 156(3) and 161(9) of the Act, the instalment base of an individual for a taxation year is the amount by which 5

(*a*) the individual's tax payable under Part I of the Act for the year, determined before taking into consideration the specified future tax consequences for the year

exceeds

(*b*) the amount deemed by subsection 120(2) of the Act to have been 10 paid on account of the individual's tax under Part I of the Act for the year, determined before taking into consideration the specified future tax consequences for the year.

2. (1) Paragraph 5301(*a*) of the Regulations is replaced by the following: 15

(*a*) the tax payable under Part I of the Act by the corporation for its taxation year preceding the particular year, and

(2) Clause 5301(4)(*a*)(i)(A) of the Regulations is replaced by the following:

(A) the tax payable under Part I of the Act, and 20

(3) Subsection 5301(10) of the Regulations is replaced by the following:

(10) For the purpose of this section, tax payable under Part I, I.3 or VI of the Act by a corporation for a taxation year means the

corporation's tax payable for the year under that Part, determined before taking into consideration the specified future tax consequences for the year.

3. Subparagraph (*b*)(ii) of the definition "excluded obligation" in subsection 6202.1(5) of the Regulations is replaced by the following: 5

(ii) a reduction, under subsection 66(12.73) of the Act, of an amount purported to be renounced to the holder in respect of the share;

4. (1) Section 1 applies for the purpose of computing instalments of tax payable for the 1997 and subsequent taxation years. 10

(2) Section 2 applies to the 1996 and subsequent taxation years.

(3) Section 3 applies to renunciations purported to be made after 1996.

Explanatory Notes

ITR
5300

Under section 156 of the Act, an individual is permitted to remit quarterly tax instalments for a taxation year on the basis of the individual's "instalment base" for the preceding taxation year. The liability of farmers and fishermen is likewise computed with reference to the "instalment base". For these purposes, an individual's "instalment base" is defined under section 5300 of the Regulations. Subject to a number of adjustments, an individual's "instalment base" for a taxation year is the individual's tax payable for the year.

Section 5300 is amended so that an individual's "instalment base" for a taxation year is computed before considering the consequences of reductions of amounts purported to be renounced after the beginning of the year pursuant to the new one year look-back rule described in the commentary to amended subsection 66(12.66) of the Act. These consequences are now included in the definition "specified future tax consequence" in subsection 248(1) of the Act. (For further detail, see the commentary on that definition.)

Section 5300 has also been amended to remove a number of references to provisions of the Act that are no longer in operation.

This amendment applies for the purpose of computing instalments of tax for the 1997 and subsequent taxation years.

ITR
5301

Under section 157 of the Act, a corporation is permitted to remit monthly tax instalments for a taxation year on the basis of its "first instalment base" and "second instalment base" for the year. Subject to a number of adjustments, a corporation's "first instalment base" for a taxation year is generally defined under section 5301 of the Regulations as the corporation's tax payable for the preceding year. Similarly, a corporation's "second instalment base" for a taxation year is generally defined as the corporation's tax payable for the second preceding taxation year.

Section 5301 is amended so that the total of a corporation's taxes payable for a taxation year under Part I, I.3 and VI of the Act is, for these purposes, determined before taking into consideration "specified future tax consequences" for the year. As described in greater detail in the new definition of the latter expression in subsection 248(1) of the Act, "specified future tax consequences" refer to adjustments arising because of the carryback of losses or similar amounts or because of corrections of certain amounts renounced in connection with the issue of flow-through shares. (For further detail, see the commentary on that definition.)

This amendment applies to the 1996 and subsequent taxation years.

ITR
6202.1(5)

"excluded obligation"

Section 6202.1 of the Regulations prescribes shares for the purpose of the definition "flow-through share" in subsection 66(15) of the Act. Shares prescribed under this section cannot qualify as "flow-through shares".

An "excluded obligation" is an obligation that does not result in a share not qualifying as a "flow-through share". The definition "excluded obligation" is amended to refer to reductions under subsection 66(12.73) of an amount purported to be renounced, in order to be consistent with the terminology employed in the flow-through share rules.

This amendment applies to renunciations purported to be made after 1996.

APPENDIX D

DRAFT *INCOME TAX REGULATIONS* AND EXPLANATORY NOTES

Bituminous Sands & Accelerated Capital Cost Allowance

1.(1) The portion of subsection 1101(4*c*) of the *Income Tax Regulations* before paragraph (*a*) is replaced by the following:

(4c) Where one or more properties of a taxpayer are described in paragraph (*a*), (*a*.1), or (*a*.2) of Class 41 in Schedule II and

(2) The portion of subsection 1101(4*d*) of the Regulations before paragraph (*a*) is replaced by the following: 5

(4d) Where more than one property of a taxpayer is described in paragraph (*a*), (*a*.1), or (*a*.2) of Class 41 in Schedule II and

2.(1) The definition "tar sands ore" in subsection 1104(2) of the Regulations is replaced by the following: 10

"tar sands ore" means ore extracted from a deposit of bituminous sands or oil shales;

(2) The portion of subsection 1104(5) of the Regulations before subparagraph (*c*)(i) is replaced by the following:

(5) For the purposes of paragraphs 1100(1)(*w*) to (*ya*), 15 subsections 1101(4*a*) to (4*d*) and Classes 10, 28 and 41 in Schedule II, a taxpayer's "income from a mine", or any expression referring to a taxpayer's income from a mine, includes income reasonably attributable to

(*a*) the processing by the taxpayer of 20

(i) ore (other than iron ore or tar sands ore) all or substantially all of which is from a mineral resource owned by the taxpayer to any stage that is not beyond the prime metal stage or its equivalent,

(ii) iron ore all or substantially all of which is from a mineral resource owned by the taxpayer to any stage that is not beyond the pellet stage or its equivalent,

(iii) tar sands ore all or substantially all of which is from a mineral resource owned by the taxpayer to any stage that is not beyond the crude oil stage or its equivalent, or 5

(iv) material extracted by a well, all or substantially of which is from a deposit of bituminous sands or oil shales owned by the taxpayer, to any stage that is not beyond the crude oil stage or its equivalent; 10

(*b*) the production by the taxpayer of material from a deposit of bituminous sands or oil shales; and

(*c*) the transportation by the taxpayer of

(3) Section 1104 of the Regulations is amended by adding the following after subsection (5): 15

(5.1) For the purpose of Class 41 in Schedule II, a taxpayer's "gross revenue from a mine", includes

(*a*) revenue reasonably attributable to the processing by the taxpayer of

(i) ore (other than iron ore or tar sands ore) from a mineral resource owned by the taxpayer to any stage that is not beyond the prime metal stage or its equivalent, 20

(ii) iron ore from a mineral resource owned by the taxpayer to any stage that is not beyond the pellet stage or its equivalent,

(iii) tar sands ore from a mineral resource owned by the taxpayer to any stage that is not beyond the crude oil stage or its equivalent, and 25

(iv) material extracted by a well from a mineral resource owned by the taxpayer that is a deposit of bituminous sands or oil shales to any stage that is not beyond the crude oil stage or its equivalent; 30

(*b*) the amount, if any, by which any revenue reasonably attributable to the processing by the taxpayer of

(i) ore (other than iron ore or tar sands ore) from a mineral resource not owned by the taxpayer, to any stage that is not beyond the prime metal stage or its equivalent, 5

(ii) iron ore from a mineral resource not owned by the taxpayer to any stage that is not beyond the pellet stage or its equivalent,

(iii) tar sands ore from a mineral resource not owned by the taxpayer to any stage that is not beyond the crude oil stage or its equivalent, and 10

(iv) material extracted by a well from a mineral resource not owned by the taxpayer that is a deposit of bituminous sands or oil shales to any stage that is not beyond the crude oil stage or its equivalent

exceeds the cost to the taxpayer of the ore or material processed; and 15

(*c*) revenue reasonably attributable to the production by the taxpayer of material from a deposit of bituminous sands or oil shales.

(5.2) For the purpose of subsection (5.1), "gross revenue from a mine" does not include revenue reasonably attributable to the addition of diluent, for the purpose of transportation, to material extracted from 20 a deposit of bituminous sands or oil shales.

(4) Paragraph 1104(6)(*a*) of the Regulations is amended by striking out the word "or" at the end of subparagraph (ii) and by adding the following after subparagraph (iii):

(iv) material extracted by a well from a mineral resource not 25 owned by the taxpayer that is a deposit of bituminous sands or oil shales to any stage that is not beyond the crude oil stage or its equivalent; and

(5) Paragraph 1104(6)(*b*) of the Regulations is replaced by the following: 30

(*b*) "mine" includes a well for the extraction of material from a deposit of bituminous sands or oil shales or from a deposit of calcium chloride, halite or sylvite.

(6) Subsection 1104(7) of the Regulations is replaced by the following: 5

(7) For the purposes of paragraphs 1100(1)(*w*) to (*ya*), subsections 1101(4a) to (4d) and 1102(8) and (9) and Classes 12, 28 and 41 in Schedule II,

(*a*) "mine" includes

(i) a well for the extraction of material from a deposit of bituminous sands or oil shales or from a deposit of calcium chloride, halite or sylvite, and 10

(ii) a pit for the extraction of kaolin or tar sands ore,

but does not include

(iii) an oil or gas well, or 15

(iv) a sand pit, gravel pit, clay pit, shale pit, peat bog, deposit of peat or a stone quarry (other than a kaolin pit or a deposit of bituminous sands or oil shales);

(*b*) all wells of a taxpayer for the extraction of material from one or more deposits of calcium chloride, halite or sylvite, the material produced from which is sent to the same plant for processing, are deemed to be one mine of the taxpayer; and 20

(*c*) all wells of a taxpayer for the extraction of material from a deposit of bituminous sands or oil shales that the Minister, in consultation with the Minister of Natural Resources, determines constitute one project, are deemed to be one mine of the taxpayer. 25

3. The portion of the description of Class 41 in Schedule II to the Regulations before paragraph (*b*) is replaced by the following:

Property

(*a*) not included in Class 28 that would otherwise be included in that Class if that Class were read without reference to paragraph (*a*) thereof, and if subparagraphs (*e*)(i) to (iii) of that Class were read as follows: 5

(i) property that was acquired before the mine came into production and that would, but for this Class, be included in Class 10 because of paragraph (*g*), (*k*), (*l*) or (*r*) of that Class or would have been so included in that Class if it had been acquired after the 1971 taxation year, and property that would, but for this 10 Class, be included in Class 41 because of subsection 1102(8) or (9),

(ii) property that was acquired before the mine came into production and that would, but for this Class, be included in Class 10 because of paragraph (*m*) of that Class, or 15

(iii) property that was acquired after the mine came into production and that would, but for this Class, be included in Class 10 because of paragraph (*g*), (*k*), (*l*) or (*r*) of that Class, and property that would, but for this Class, be included in Class 41 because of subsection 1102(8) or (9); 20

(*a*.1) that is the portion, expressed as a percentage determined by reference to capital cost, of property that

(i) would, but for this Class, be included in Class 10 because of paragraph (*g*), (*k*), or (*l*) of that Class, or that is included in this Class because of subsection 1102(8) or (9), 25

(ii) is not described in paragraph (*a*) or (*a*.2),

(iii) was acquired by the taxpayer principally for the purpose of gaining or producing income from a mine that is operated by the taxpayer and situated in Canada, and that became available for use for the purpose of subsection 13(26) of the Act in a taxation year, 30 and

(iv) had not, before it was acquired by the taxpayer, been used for any purpose by any person or partnership with whom the taxpayer was not dealing at arm's length, where that percentage is determined by the formula

$$100 \times [A - (B \times 365/C)]/A$$ 5

where

A is the total of all amounts each of which is the capital cost of a property of the taxpayer that became available for use for the purpose of subsection 13(26) of the Act in the year and that is described in subparagraphs (i) to (iv) in respect of the mine, 10

B is 5% of the taxpayer's gross revenue from the mine for the year, and

C is the number of days in the year;

(*a*.2) that

(i) is property that would, but for this Class, be included in Class 10 because of paragraph (*g*), (*k*), or (*l*) of that Class or that is included in this Class because of subsection 1102(8) or (9), 15

(ii) was acquired by the taxpayer in a taxation year principally for the purpose of gaining or producing income from a mine

(A) that is one or more wells operated by the taxpayer for the extraction of material from a deposit of bituminous sands or oil shales, operated by the taxpayer and situated in Canada, 20

(B) that was the subject of a major expansion after March 6, 1996, and

(C) in respect of which the Minister, in consultation with the Minister of Natural Resources, is satisfied that the greatest designed capacity of the mine, measured in barrels of oil that is not beyond the crude oil stage or its equivalent, immediately after the expansion was not less than 25 per cent greater than the greatest designed capacity of the mine immediately before the expansion, 25 30

(iii) was acquired by the taxpayer

(A) after March 6, 1996,

(B) before the completion of the expansion, and

(C) in the course of and principally for the purposes of the expansion, and 5

(iv) had not, before it was acquired by the taxpayer, been used for any purpose by any person or partnership with whom the taxpayer was not dealing at arm's length;

(*a*.3) that is property included in this Class because of subsection 1102(8) or (9), other than property described in 10 paragraph (*a*) or (*a*.2) or the portion of property described in paragraph (*a*.1);

4. The description of Class 41 in Schedule II is amended by adding the word "or" at the end of subparagraph (*b*)(i).

5.(1) Sections 1 and 2 apply after March 6, 1996. 15

(2) Section 3 applies in respect of property acquired after March 6, 1996, except that paragraphs (*a*) and (*a*.3) of the description of Class 41 in Schedule II, as enacted by section 3, apply in respect of property acquired after 1987.

(3) Section 4 applies in respect of property acquired after 20 February 25, 1992.

Explanatory Notes

This appendix contains proposed regulations required to give effect to two 1996 Budget proposals. The first is that the cost of mining property included in capital cost allowance (CCA) Class 41 that becomes available for use in a year, in excess of five percent of the gross revenue from the mine for the year, would qualify for accelerated capital cost allowance. The second is that all oil sands projects, whether of the surface mining type or the "in-situ" type, would be treated as mines for CCA purposes.

ITR
1101

Section 1101 of the Regulations provides that certain property described in Schedule II to the Regulations must be included in a separate prescribed class.

Subsection 1101(4c) generally provides that all of a taxpayer's property described in paragraph (*a*) of Class 41 and acquired for the purpose of gaining or producing income from one mine is to be included in a separate class.

Subsection 1101(4d) generally provides that, where a taxpayer has more than one property described in paragraph (*a*) of Class 41, and one of the properties was acquired for the purpose of gaining or producing income from particular mines and another of the properties was acquired for the purpose of gaining or producing from another mine or mines, a separate class is prescribed for the properties acquired for the purpose of gaining or producing income from the particular mines.

Subsections 1101(4c) and (4d) are amended, consequential on the introduction of paragraphs (*a*.1) and (*a*.2) of Class 41, to add references to these new paragraphs.

This amendment applies after March 6, 1996.

ITR
1104(2)

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

"tar sands ore"

The definition "tar sands ore" in subsection 1104(2) is amended to include material extracted through a well from a deposit of bituminous sands or oil shales. This amendment, which applies after March 6, 1996 is consequential on the 1996 budget proposal that all oil sands projects, whether of the surface mining type or the "in-situ" type, would be treated as mines for capital cost allowance purposes.

ITR
1104(5) to (7)

Subsections 1104(5) to (7) of the Regulations contain a number of rules of interpretation relevant for the purpose of CCA Class 41. Class 41 is described in more detail in the notes to the amendments to that Class.

ITR
1104(5)

Subsection 1104(5) of the Regulations provides that "income from a mine" includes certain amounts for the purposes of several provisions in Part XI of the Regulations and Schedule II that refer to such income.

Subsection 1104(5) is amended so that the definition also applies for the purpose of subsections 1101(4a) to (4d) of the Regulations, and Class 41 of Schedule II.

Subparagraph 1104(5)(*a*)(iii) is amended so that, for these purposes, "income from a mine" also includes income from the processing of tar sands ore that is all or substantially all (rather than completely) from a mineral resource owned by the taxpayer. New subparagraph 1104(5)(*a*)(iv) is introduced so that "income from a

mine" also includes income from the processing of other material extracted from a deposit of bituminous sands (i.e. from an "in-situ" well).

Paragraph 1104(5)(*b*) is amended to eliminate the previously existing exclusion from "income from a mine" of income from the production, from a well, of crude oil from bituminous sands or oil shales.

These amendments accommodate the 1996 Budget proposal to treat oil sands projects as mines regardless of whether they are open pit mines or "in-situ" projects.

These amendments apply after March 6, 1996.

ITR
1104(5.1)

New subsection 1104(5.1) of the Regulations provides that certain amounts are included in "gross revenue from a mine" for the purpose of Class 41 in Schedule II. Specifically, in addition to including gross revenue in respect of amounts which are included in "income from a mine" under subsection 1104(5), revenue from what is known in the industry as "custom processing", less the cost to the taxpayer of the ore or material so processed, is included in gross revenue from a mine.

The concept of gross revenue from a mine is introduced in order to implement the 1996 budget proposal regarding an accelerated capital cost allowance for the cost of Class 41 property, that becomes available-for-use in a year, in excess of 5% of gross revenue from the mine for the year.

This amendment applies after March 6, 1996.

ITR
1104(6)

Subsection 1104(6) of the Regulations provides that, for the purposes of Class 10 in Schedule II, "income from a mine" includes the amounts specified. In particular, subsection 1104(6) provides for the inclusion in such income of income from "custom processing" for the purposes of Class 10 in Schedule II.

Subsection 1104(6) is amended consequential on the 1996 budget proposal to treat oil sands projects as mines regardless of whether they are open pit mines or "in-situ" projects. Paragraph 1104(6)(*a*) is amended by adding new subparagraph (iv) which describes custom processing in respect of oil sands "in-situ" projects.

Paragraph 1104(6)(*b*) is amended by adding a well for the extraction of material from a deposit of bituminous sands or oil shales to the list of types of wells deemed to be mines for the purpose of Class 10 in Schedule II.

These amendments apply after March 6, 1996.

ITR
1104(7)

Subsection 1104(7) of the Regulations provides rules for the determination of whether extraction facilities constitute a mine for the purposes of paragraphs 1100(1)(*w*) to (*ya*) and subsections 1101(4a) to (4d) and 1102(8) and (9) of the Regulations and Classes 12 and 28 in Schedule II to the Regulations.

Subsection 1104(7) is amended so that it also applies for the purpose of Class 41. Paragraph 1104(7)(*a*) is amended consequential on the 1996 budget proposal to treat oil sands projects as mines regardless of whether they are open pit mines or "in-situ" projects. The amendment provides that wells for the extraction of material from a deposit of bituminous sands or oil shales are mines for the purposes of the provisions referred to therein.

New paragraph 1104(7)(*c*) provides that all bituminous sands "in-situ" wells that the Minister of National Revenue, in consultation with the Minister of Natural Resources, has determined constitute one project, shall be deemed to be one mine of the taxpayer.

These amendments apply after March 6, 1996.

Schedule II
Class 41
Paragraphs (*a*.1) and (*a*.2)

Schedule II to the Regulations provides for various classes of depreciable property, the undepreciated capital cost of which may be deducted in accordance with the rates set out in subsection 1100(1) of the Regulations.

Class 41 of Schedule II generally includes certain property acquired for use in a mine, as well as oil or gas exploration and drilling vessels. Mining property described in paragraph (*a*) of Class 41 is eligible for the accelerated capital cost allowance (CCA) allowable under paragraphs 1100(1)(*y*) and (*ya*) of the Regulations, which generally allow for the deductibility of CCA in respect of such property up to the income from the mine for the year. The CCA rate for property described in paragraph (*b*) of Class 41 is 25%.

Paragraph (*a*) of Class 41 is amended to correct an anomaly which technically prevented property referred to in subsections 1102(8) and (9) of the Regulations (electrical plant from mining) from being included in paragraph (*a*) of Class 41 where it was part of a major mine expansion and met the other requirements for inclusion in paragraph (*a*).

This amendment, which is relieving, applies in respect of property acquired after 1987.

New paragraph (*a*.1) of Class 41 implements the 1996 budget proposal for an accelerated capital cost allowance for the cost of Class 41 property, that becomes available for use in respect of a mine in a year, in excess of 5% of the gross revenue from the mine for the year. The portion of a taxpayer's expenditures on depreciable property, described in subparagraphs (*a*.1) (i) to (iv) of Class 41 for a year, in excess of 5% of the gross revenue from the mine for the year, is eligible for the same accelerated capital cost allowance available for property described in paragraph (*a*) of Class 41.

EXAMPLE

A corporation has gross revenue from a mine of $2,800,000 in a taxation year of 280 days. In that year, the taxpayer's "Class 41 property" which became available for use had a total capital cost of $400,000 and consisted of 100 separate properties.

The percentage of the capital cost of each such property which would be entitled to the accelerated CCA under paragraph (a.1) of Class 41 would be calculated as follows:

$$\frac{100 \times [A - (B \times 365/C)]}{A}$$

where

A is the total capital cost of all of the taxpayer's properties that became available for use for the purpose of subsection 13(26) of the Act in the year and are described in subparagraphs (i) to (iv), (in this case, $400,000),

B is 5% of the taxpayer's gross revenue from the mine for the year (in this case, $140,000), and

C is the number of days in the year (in this case 280).

In this case, therefore, the formula yields the following:

$$\frac{100 \times [400{,}000 - (140{,}000 \times 365/280)]}{400{,}000} = 42.625$$

Therefore, 42.625% of the cost of each such property would be included under paragraph (a.1) of Class 41, and the balance of the cost of each such property would be included under paragraph (b) of that Class.

New paragraph (*a*.2) of Class 41 is introduced to implement the 1996 budget proposal to treat oil sands "in-situ" projects as mines for capital cost allowance purposes. This paragraph provides a "major mine expansion" test for "in-situ" projects, analogous to the existing "major mine expansion" test in Class 28, for the purpose of determining eligibility for accelerated capital cost allowance.

New paragraph (*a*.3) of Class 41 provides a required cross-reference for property referred to in subsections 1102(8) and (9) (electrical plant for mining), which is required to be included in Class 41. The property described in new paragraph (*a*.3) is not eligible for the accelerated CCA, but is accorded the same 25% CCA rate as property described in paragraph (*b*).

This clarifying amendment applies in respect of property acquired after 1987.

These amendments apply in respect of property acquired after March 6, 1996, except as otherwise noted. Other amendments to Class 41 are contained in Appendix A to these Explanatory Notes.

APPENDIX E

DRAFT *INCOME TAX REGULATIONS* AND EXPLANATORY NOTES

Canadian Renewable and Conservation Expense

1. Subsection 1102(1) of the *Income Tax Regulations* is amended by adding the following after paragraph (*a*):

(*a*.1) the cost of which is included in the taxpayer's Canadian renewable and conservation expense (within the meaning assigned by section 1219);

2. The portion of the definition "Canadian exploration and development overhead expense" in subsection 1206(1) of the Regulations before paragraph (*a*) is replaced by the following:

"Canadian exploration and development overhead expense" of a taxpayer means a Canadian exploration expense or a Canadian development expense of the taxpayer made or incurred after 1980 that is not a Canadian renewable and conservation expense (in this definition having the meaning assigned by section 1219) nor a taxpayer's share of a Canadian renewable and conservation expense incurred by a partnership and

3. Part XII of the Regulations is amended by adding the following after section 1218:

CANADIAN RENEWABLE AND CONSERVATION EXPENSE

1219. (1) Subject to subsection (2), for the purpose of the definition "Canadian renewable and conservation expense" in subsection 66.1(6) of the Act, "Canadian renewable and conservation expense" means an expense incurred by a taxpayer, and payable to a person or partnership with whom the taxpayer is dealing at arm's length, in respect of the development of a project for which it is reasonable to expect that at least 50% of the capital cost of the depreciable property to be used in the project would be the capital cost of property described in Class 43.1 in Schedule II, and includes such an expense incurred by the taxpayer

(*a*) for the purpose of making a service connection to the project for the transmission of electricity to a public utility, to the extent that the expense so incurred was not incurred to acquire property of the taxpayer;

(*b*) for the construction of a temporary access road to the project site; 5

(*c*) for a right of access to the project site in respect of the period ending at the earliest time at which a property described in Class 43.1 in Schedule II is used in the project for the purpose of earning income;

(*d*) for clearing land to the extent necessary to complete the project; 10

(*e*) for process engineering for the project including

(i) collection and analysis of site data,

(ii) calculation of energy, mass, water, or air balances,

(iii) simulation and analysis of the performance and cost of process design options, and 15

(iv) selection of the optimum process design; or

(*f*) for the drilling or completion of a well for the project.

(2) A Canadian renewable and conservation expense does not include any expense incurred by a taxpayer that is directly or indirectly

(*a*) for the acquisition of, or the use of or the right to use, land, 20 except as provided by paragraph (1)(*b*), (*c*) or (*d*);

(*b*) for grading or levelling land or for landscaping, except as provided by paragraph (1)(*b*);

(*c*) payable to a non-resident person or a partnership other than a Canadian partnership; 25

(*d*) included in the capital cost of property that, but for this section, would be depreciable property, except as provided by paragraph (1)(*b*),(*d*), (*e*) or (*f*);

(*e*) an expenditure that, but for this section, would be an eligible capital expenditure, except as provided by any of paragraphs (1)(*a*) to (*e*);

(*f*) included in the cost of inventory;

(*g*) an expenditure on or in respect of scientific research and experimental development; 5

(*h*) a Canadian development expense or a Canadian oil and gas property expense;

(*i*) incurred, for a project, in or in respect of the period beginning at the earliest time at which a property described in Class 43.1 in Schedule II is used in the project for the purpose of earning income; 10

(*j*) incurred in respect of the administration or management of a business of the taxpayer;

(*k*) incurred in respect of the upkeep or maintenance of, taxes or insurance in respect of, or rental or leasing of, property other than property described in Class 43.1 in Schedule II; 15

(*l*) incurred in respect of financing for the project; or

(*m*) a cost attributable to the period of the construction, renovation or alteration of depreciable property, other than property described in Class 43.1 of Schedule II, that relates to 20

(i) the construction, renovation or alteration of the property (except as provided by paragraph (1)(*b*) or (*f*)), or

(ii) the ownership of land during the period (except as provided by paragraph (1)(*b*), (*c*) or (*d*)).

4. Sections 1 to 3 apply to expenses incurred after ANNOUNCEMENT DATE. 25

Explanatory Notes

The 1996 budget proposed the introduction of a new category of expenditures, Canadian renewable and conservation expenses (CRCE), which would include intangible costs for projects the equipment for which is included in Capital Cost Allowance Class 43.1. The budget proposed that the tax treatment of these expenses would be analogous to that of Canadian Exploration Expenses. In particular, the budget proposed that CRCE would be fully deductible and capable of being renounced to shareholders who have entered into a flow-through share agreement. The budget also stated that CRCE would take effect only after the definition of eligible costs had been developed in consultation with Natural Resources Canada and industry representatives. The proposed regulations contained in this Appendix, in conjunction with certain amendments to sections 66 and 66.1 of the Act, give effect to this budget announcement.

ITR
1102(1)

Part XI of the Regulations sets out rules for the deduction of capital cost allowance. Subsection 1102(1) of the Regulations provides that certain properties are excluded from the classes of depreciable property in Schedule II to the Regulations.

Subsection 1102(1) is amended to add proposed paragraph (*a*.1), consequential on the introduction of the definition CRCE in subsection 66.1(6) of the Act, in order to ensure that an expenditure which is deductible as CRCE is not also included as the capital cost of depreciable property.

ITR
1206(1)

Part XII of the Regulations sets out a number of rules which affect the resource sector.

Subsection 1206(1) of the Regulations sets out definitions that are relevant for the purposes of Part XII.

"Canadian exploration and development overhead expense"

The definition "Canadian exploration and development overhead expense" (CEDOE) generally applies for the purpose of the flow-through share rules prohibiting renunciation of such an overhead expense. This definition is amended, consequential on the introduction of the CRCE definition in subsection 66.1(6) of the Act, to exclude CRCE from CEDOE. Overhead expenses are, however, generally excluded from CRCE by proposed subsection 1219(2).

ITR
1219

Proposed amendments to subsection 66.1(6) of the Act define "Canadian renewable and conservation expense" (CRCE) as having the meaning assigned by regulation. For this purpose, the Technical Guide on this topic published by the Department of Natural Resources is to apply conclusively with respect to engineering and scientific matters in the determination of whether an expense meets the criteria set out in the Regulations.

New section 1219 of the Regulations assigns the meaning of the term "Canadian renewable and conservation expense" for the purpose of the definition of that term in subsection 66.1(6) of the Act.

Subsection 1219(1) of the Regulations states, generally, that CRCE means an expense incurred in respect of the development of projects for which it is expected that at least half the depreciable property to be used in the project will be described in Class 43.1 of Schedule II to the Regulations. The determination of the proportion of depreciable property that is described in Class 43.1 is to be made by reference to capital cost.

Subsection 1219(1) goes on to list six types of expenditure which are specifically included in CRCE and which, because of the exclusions listed in subsection 1219(2), might otherwise have been ineligible for treatment as CRCE.

Subsection 1219(2) lists expenses which are specifically excluded from the CRCE definition.

These amendments apply after ANNOUNCEMENT DATE.