Explanatory Notes to a Ways and Means Motion Amending the Income Tax Act and Related Acts

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

June 1996

Canada

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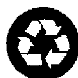

PREFACE

The draft 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 various other Acts. Two draft amendments to the *Income Tax Regulations*, one with a corresponding explanatory note, 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.

Cette publication est également offerte en français.

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Clause 2

Group Disability Benefits - Insolvent Insurer

ITA
6(17)

New subsection 6(17) of the Act defines certain expressions for the purposes of that subsection and new subsection 6(18) of the Act.

"disability policy"

A "disability policy" is a group disability insurance policy that provides periodic payments to individuals in respect of lost employment income.

"employer"

The meaning of the term "employer" is expanded to include a former employer of an individual.

"top-up disability payment"

A "top-up disability payment" is a payment which an employer makes because of the insolvency of an insurer, where the payment is one of the following types.

The first type of top-up payment is a payment to an insurer so that periodic payments under a disability policy are not reduced because of the insolvency, or are reduced by a lesser amount than would otherwise be the case. Payments of this type may be made to the insolvent insurer, or to another insurer that has assumed the obligations of the insolvent insurer under the policy.

The other type of top-up payment is a payment made by the employer directly to an individual to replace all or part of the periodic payments that, because of the insolvency, are no longer being made to the individual under a disability policy. There must be an arrangement which requires the individual to reimburse the employer to the extent that the individual later recovers the periodic payments that the employer's payments were intended to replace.

For the purpose of this definition, if a disability policy is replaced by another insurance policy, the new policy is considered to be the same policy as the disability policy.

ITA
6(18)

New subsection 6(18) contains rules that apply where an employer makes a top-up disability payment (as defined in subsection 6(17)) in respect of an individual.

Paragraph 6(18)(a) provides that a top-up disability payment is considered not to be a benefit for the purpose of paragraph 6(1)(a) of the Act. As a result, the payment is not included in the individual's income under that paragraph.

Paragraph 6(18)(b) provides that a top-up disability payment is considered not to be an employer contribution to the disability insurance plan of which the disability policy is or was a part. This provision applies for the purpose of paragraph 6(1)(f) of the Act, which includes periodic payments in an individual's income if they are received under a disability insurance plan to which the individual's employer has contributed. Thus, a top-up disability payment made in respect of a disability insurance plan that had been funded solely by employee contributions will not cause the benefits paid under the plan to become taxable.

Paragraph 6(18)(c) provides that a top-up disability payment made directly to an individual is considered to be an amount payable to the individual pursuant to the disability insurance plan. This provision, which applies for the purpose of paragraph 6(1)(f), is relevant where the employer contributed to the disability insurance plan. Paragraphs 6(18)(a) and (c) result in the top-up payment being taxable under paragraph 6(1)(f), rather than paragraph 6(1)(a), thus enabling contributions made by the individual to be taken into account in determining the amount the individual is required to include in income in respect of the payment.

New subsections 6(17) and (18) apply to top-up disability payments that are made after August 10, 1994.

Clause 3

Income from Office or Employment - Deductions

ITA
8(1)

Subsection 8(1) of the Act specifies the amounts that a taxpayer may deduct in computing income from an office or employment.

Subclause 3(1)

ITA
8(1)(n)

Paragraph 8(1)(n) of the Act provides a deduction to an individual who repays an amount received from an employer for a period throughout which the individual did not perform the duties of an office or employment. This paragraph is amended so that it does not apply where the individual makes a repayment under an arrangement described in subparagraph (b)(ii) of the definition of "top-up disability payment" in new subsection 6(17). A deduction in respect of such repayments is provided by new paragraph 8(1)(n.1). This amendment applies with respect to top-up disability payment arrangements that are entered into after August 10, 1994.

Subclause 3(2)

ITA
8(1)(n.1)

New paragraph 8(1)(n.1) provides a deduction to an individual who reimburses a top-up disability payment. For purposes of this paragraph, a top-up disability payment (as defined in new subsection 6(17)) is a payment made to the individual by an employer or former employer to replace periodic disability payments that are not made to the individual because of the insolvency of an insurer, where the individual is required to reimburse the payment to the extent that he or she ultimately receives an amount from an insurer in respect of the disability payments.

The deduction under paragraph 8(1)(n.1) is limited to the amount included in the individual's income under paragraph 6(1)(f) in respect of the payment received from the insurer. In the case of a plan funded solely by employee contributions, the payment from the insurer will not be taxable, and so there will be no deduction for the reimbursement. If employer contributions have been made to the plan, the reimbursement payment will normally be fully deductible. However, the deduction could be less than the amount of the reimbursement where the individual has contributed to the plan and these contributions reduce the amount of the payment from the insurer that is taxed.

The deduction under paragraph 8(1)(n.1) is available in the year in which the reimbursement payment is made, with one exception. Where the reimbursement payment is made within 60 days after the end of the year in which the individual receives the amount from the insurer, the payment is deductible in the year in which the amount is received rather than in the year in which the payment is made.

This amendment applies to reimbursement payments made after August 10, 1994.

Clause 4

Valuation of Inventory

ITA
10

Section 10 of the Act sets out rules for the valuation of inventory for the purpose of computing income.

Subclause 4(1)

ITA
10(1), (1.01) and (1.1)

Subsection 10(1) of the Act is amended to provide that the inventory valuation methods it describes are available only for the purpose of computing income from businesses which are not adventures or

concerns in the nature of trade. Former subsection 10(1) applied for the purpose of computing income from any business.

Subsection 10(1) is also amended to clarify that, in valuing property at the lower of cost and fair market value, the reference to cost is to the original cost of the property. Similarly, subsection 10(1) is amended to clarify that the reference therein to fair market value is to fair market value at the end of the taxation year. Businesses which have valued their inventory at an amount lower than either the original cost or the current fair market value will, therefore, be required to revalue the inventory at the lower of fair market value at the end of the taxation year and original cost.

New subsection 10(1.01) of the Act provides that property described in an inventory of a business that is an adventure or concern in the nature of trade shall be valued at its cost to the taxpayer.

Subsection 10(1.1) is amended consequential on the introduction of subsections 10(1.01) and (10) to clarify that the deemed cost provisions of subsection 10(1.1) apply to an adventure or concern in the nature trade as well as to a business carried on by the taxpayer.

These amendments apply to taxation years that end after December 20, 1995. In respect of adventures or concerns in the nature of trade, these amendments also apply to taxation years that ended before December 21, 1995 with the following exceptions:

(a) where the filing-due date of the taxpayer for the taxation year is after December 20, 1995; or

(b) where the taxpayer claimed a loss for the year in respect of the property using the valuation method allowed under subsection 10(1) in an income tax return, a notice of objection or a notice of appeal, filed before December 21, 1995.

In addition, in respect of adventures or concerns in the nature of trade, these amendments apply to fiscal periods of a partnership that ended before December 21, 1995 with the following exceptions:

(a) where the filing-due dates of all the members of the partnership for their taxation years which include the end of the partnership's fiscal period are after December 20, 1995; or

(b) where the partnership has computed a loss for the fiscal period in respect of the property using the valuation method allowed under subsection 10(1), which computation is reflected in a tax return, a notice of objection or a notice of appeal filed by a member of the partnership before December 21, 1995.

Subclause 4(2)

ITA
10(2.1)

Subsection 10(2.1) is amended consequential on the introduction of new subsection (1.01) to specify that subsection (2.1) does not apply to property described in the inventory of a business that is an adventure or concern in the nature of trade.

This amendment applies to taxation years that end after December 20, 1995. In respect of adventures or concerns in the nature of trade, this amendment also applies to taxation years that ended before December 21, 1995 with the following exceptions:

(a) where the filing-due date of the taxpayer for the taxation year is after December 20, 1995; or

(b) where the taxpayer claimed a loss for the year in respect of the property using the valuation method allowed under subsection 10(1) in an income tax return, a notice of objection or a notice of appeal, filed before December 21, 1995.

In addition, in respect of adventures or concerns in the nature of trade, this amendment applies to fiscal periods of a partnership that ended before December 21, 1995 with the following exceptions:

(a) where the filing-due dates of all the members of the partnership for their taxation years which include the end of the partnership's fiscal period are after December 20, 1995; or

(b) where the partnership has computed a loss for the fiscal period in respect of the property using the valuation method allowed under subsection 10(1), which computation is reflected in a tax return, a notice of objection or a notice of appeal filed by a member of the partnership before December 21, 1995.

Subclause 4(3)

ITA
10(9) and (10)

New subsection 10(9) of the Act provides a transitional rule in respect of property, described in an inventory of a business that is an adventure or concern in the nature of trade, that was "written-down" by a taxpayer under subsection 10(1) for a taxation year for which that valuation method was available. In those circumstances, the cost of the property to the taxpayer after that time is deemed to be the value last assigned by the taxpayer under subsection 10(1). For taxation years to which these amendments apply, the taxpayer may then add any amounts includible under subsection (1.1).

New subsection 10(10) of the Act provides that, at the end of a corporation's last taxation year before a change in control, property described in an inventory of a business that is an adventure or concern in the nature of trade shall be valued at the lower of its original cost and its fair market value at the end of that year. After that time, that lower amount is deemed to be the cost at which the property was acquired by the taxpayer.

These amendments apply to taxation years that end after December 20, 1995. In respect of adventures or concerns in the nature of trade, these amendments also apply to taxation years that ended before December 21, 1995 with the following exceptions:

(a) where the filing-due date of the taxpayer for the taxation year is after December 20, 1995; or

(b) where the taxpayer claimed a loss for the year in respect of the property using the valuation method allowed under subsection 10(1) in an income tax return, a notice of objection or a notice of appeal, filed before December 21, 1995.

In addition, in respect of adventures or concerns in the nature of trade, these amendments apply to fiscal periods of a partnership that ended before December 21, 1995 with the following exceptions:

(a) where the filing-due dates of all the members of the partnership for their taxation years which include the end of the partnership's fiscal period are after December 20, 1995; or

(b) where the partnership has computed a loss for the fiscal period in respect of the property using the valuation method allowed under subsection 10(1), which computation is reflected in a tax return, a notice of objection or a notice of appeal filed by a member of the partnership before December 21, 1995.

Clause 5

Income from Business or Property - Inclusions

ITA
12(1)(x)

Paragraph 12(1)(x) provides that certain inducements, reimbursements, contributions, allowances and assistance received by a taxpayer in the course of earning income from a business or property will be included in income to the extent that they have not otherwise reduced the cost of a property or the amount of an outlay or expense. This amendment adds a reference to amounts refunded as well as the condition that the amount received will only be included in income to the extent that it has not resulted in an assessment that reflected a reduction in the cost of a property or the amount of an outlay or expense. This amendment applies to amounts received after 1990.

Clause 6

Life Insurance Policies - Inclusions in Computing Income

ITA
12.2(10)

Subsection 12.2(10) of the existing Act provides that a rider added after 1989 to a life insurance policy last acquired by a taxpayer before 1990 is to be treated as a separate policy. This rule prevents a taxpayer from obtaining life insurance coverage after 1989

that is not subject to annual accrual reporting under subsection 12.2(1) by adding additional coverage to an existing policy.

Subsection 12.2(10) is amended so that it does not apply to a rider added after 1989 to an exempt policy last acquired after December 1, 1982. The exclusion makes the treatment of such riders consistent with the treatment of riders added to exempt policies acquired after 1989. In both cases, if the rider causes the exempt policy to lose its exempt status, the policy will become subject to annual accrual reporting.

Clause 7

Recaptured Depreciation

ITA
13

Section 13 of the Income Tax Act provides rules relating to depreciable property. Generally, these rules apply for the purposes of sections 13 and 20 of the Act and the capital cost allowance regulations.

Subclause 7(1)

ITA
13(4)

Subsection 13(4) of the Act allows a taxpayer who incurs recapture on the disposition of certain property to defer tax on the recapture to the extent that the taxpayer reinvests the proceeds of disposition in a replacement property within a certain period of time.

This amendment to subsection 13(4) is consequential on the amendment of subsection 13(4.1) of the Act. Generally, the condition in subsection 13(4) requiring a taxpayer to acquire a property as a replacement for the taxpayer’s former property is being moved to subsection 13(4.1). For additional details, see the commentary on the amendment to subsection 13(4.1).

This amendment applies to dispositions of former properties occurring after the 1993 taxation year.

Subclause 7(2)

ITA
13(4.1)

Subsection 13(4.1) of the Act describes the conditions under which a depreciable property acquired by a taxpayer will be a replacement property for the purposes of subsection 13(4) of the Act.

Subsection 13(4.1) is amended in two ways. First, new paragraph 13(4.1)(a) provides that a particular depreciable property of a prescribed class of a taxpayer will not be considered to be a replacement property unless it is reasonable to conclude that the property was acquired by the taxpayer to replace the former property.

Second, former paragraph 13(4.1)(a), which becomes new paragraph 13(4.1)(a.1), is clarified to refer to the acquired property being "used by the taxpayer or a person related to the taxpayer" for the same or a similar use to which the taxpayer or a person related to the taxpayer put the former property. A property acquired by a taxpayer is not necessarily denied replacement property treatment simply because it is used by a related person rather than by the taxpayer. This may occur, for example, where a taxpayer rents the acquired property to a related person who uses it in the same or similar business. For additional details, see the commentary on the amendments to subsections 14(6) and (7) and subsections 44(1) and (5) of the Act.

These amendments apply to dispositions of former properties occurring after the 1993 taxation year.

Subclause 7(3)

ITA
13(7)(f)

Subsection 13(7) of the Act sets out rules relating to the capital cost of depreciable property. Paragraph 13(7)(f) applies where a corporation is treated as having disposed of and reacquired

depreciable property either under paragraph 111(4)(e) (on an acquisition of control of the corporation) or paragraph 149(10)(b) of the Act (where the corporation becomes or ceases to be exempt from tax under Part I of the Act). Paragraph 13(7)(f) limits any resulting increase in the capital cost of the property to 3/4 of the amount by which the corporation's deemed proceeds of disposition exceed the property's capital cost at the time of the disposition.

As part of a series of amendments relating to the tax treatment of corporations whose tax status changes, the reference in subsection 13(7) to paragraph 149(10)(b) is deleted after April 26, 1995.

Subclause 7(4)

ITA
13(21.2)

New subsection 13(21.2) of the Act applies on the transfer, by a corporation, trust or partnership, of a depreciable property whose tax cost is greater than the amount that would otherwise be the transferor's proceeds from the transfer. Where these conditions exist, and the transferor or a person "affiliated" with the transferor holds or has a right to acquire the property 30 days after the disposition, no loss may be recognized on the transfer. Instead, such a loss is deferred until the earliest of the following events:

- a subsequent disposition of the property to a person that is neither the transferor nor a person affiliated with the transferor (provided that neither the transferor nor an affiliated person acquires or has a right to acquire the property within 30 days after that later disposition);

- a change in the property's use from an income-earning to a non-income-earning purpose;

- a "deemed disposition" of the property under section 128.1 (change of residence) or subsection 149(10) (change of taxable status);

- where the transferor is a corporation, an acquisition of control of the transferor; or

- where the transferor is a corporation, a winding-up of the transferor (other than a winding-up under subsection 88(1) of the Act).

The tax cost of a depreciable property is, for the purposes of this rule, treated as being the proportion of the undepreciated capital cost of the class to which the property belongs that the value of that property is of the value of all properties in the class. The amount by which that tax cost exceeds the amount that would otherwise be the transferor's proceeds of disposition of the transferred property's value is treated as the capital cost of a property, of the same class as that from which the property came, acquired by the transferor before the taxation year in which the transfer took place. This new property will be treated as being owned by the transferor until the earliest of the events described above. As a result, the transferor will be permitted to claim capital cost allowance (CCA) after the transfer on the difference between the transferred property's tax cost and the transferor's proceeds of disposition otherwise determined. As well, any portion of the difference not claimed as CCA may be eligible for recognition as a terminal loss when any of the events described above occurs, provided the transferor has no other properties of the same class.

New subsection 13(21.2) replaces subsection 85(5.1) of the Act, which denied the recognition of a loss on the transfer of a depreciable property to a corporation controlled by the transferor or that controlled the transferor. However, new subsection 13(21.2) differs from subsection 85(5.1) in two material respects. First, new subsection 13(21.2) does not apply to transfers by individuals other than trusts, but can, as a result of its adoption of the definition of "affiliated persons" in new section 251.1 of the Act (see the commentary on that section for a fuller description), apply to depreciable property transfers to individuals, corporations and partnerships in cases where subsection 85(4) would not have applied. Second, the new rule does not pass the excess of tax cost over a property's value on to the transferee but instead retains it in the transferor's hands to be amortized and (to the extent of any unamortized portion) deducted as a terminal loss.

As noted, new subsection 13(21.2) applies to transferors that are partnerships. New paragraph 13(21.2)(f) clarifies the result where a transferor partnership ceases to exist after a disposition but before any of the events that put an end to its deemed ownership of the notional

depreciable property have occurred. Where a partnership would otherwise cease to exist after a disposition to which new subsection 13(21.2) applies, the partnership is treated as not having ceased to exist, and each person who was a member of the partnership before it would otherwise cease to exist is treated as having remained a member of the partnership. This deemed continuation of the partnership (and of the membership of each partner) continues until the time that is immediately after the first of the events that end the partnership's deemed ownership of the notional depreciable property.

Finally, new subsection 13(21.2) provides, in paragraph (g), that the "subsequent owner" of the transferred property – that is, the transferor or a person affiliated with the transferor – is treated for the purposes of measuring any potential recapture with respect to the transferred property as having the same capital cost of the property as the it had to the transferor, and as having deducted as capital cost allowance in previous years the amount by which the capital cost of the transferred property exceeds the property's value at the time of disposition.

New subsection 13(21.2) applies to dispositions of property that take place after April 26, 1995, with three exceptions. The first two of these are found in clause 156, and generally exclude transactions in progress before April 27, 1995. Readers may refer to the notes to clause 156 for more detail.

The third exception is that where a property is disposed of after April 26, 1995, and before ANNOUNCEMENT DATE, the transferor may elect to treat the notional depreciable property created on the transfer as a property of a separate class that is identical to the class of the property disposed of. This election, which preserves the effect of the 1995 draft version of subsection 13(21.2), must be made in writing before the end of the third month after the month in which this Act is assented to.

Subclause 7(5)

ITA
13(24)

Subsection 13(24) of the Act applies where a corporation or a partnership of which a corporation is a majority interest partner has acquired a depreciable property within the 12-month period ending immediately before control of the corporation is acquired, and the property was not used or acquired for use in a business carried on before that period. Under this rule, the capital cost of the property will not be included in computing undepreciated capital cost after the acquisition of control and, for the purposes of the investment tax credit and refundable investment tax credit, the property will not be considered to have been acquired until after the acquisition of control. This subsection is amended as a consequence of the introduction of the concept of "affiliated persons" in new section 251.1 of the Act. Subsection 13(24) formerly contained an exception from its application where the property in question was owned during the 12-month period described above by the corporation whose control was acquired by a partnership, of which the corporation was a majority interest partner, or by a person or persons related to the corporation. As amended, this exception will apply where the property was owned by a person that was affiliated with the corporation, within the meaning that would be assigned by new section 251.1 if that section were read without reference to the extended definition of "controlled" in subsection 251.1(2).

Amended subsection 13(24) of the Act applies to acquisitions of control that occur after April 26, 1995.

Subclause 7(6)

ITA
13(27)(d)

Subsection 13(27) of the Act, in conjunction with subsections 13(29) to (32) establishes the time at which property (other than a building) is considered to have become available for use by a taxpayer for the purposes of determining, under subsection 13(26), the taxation year in which capital cost allowance may first be claimed.

Paragraph 13(27)(d) is amended to clarify the circumstances in which property which is capable of producing a commercially saleable product or service is considered to be first available for use. Such property must be delivered (or where not of a type generally considered to be deliverable - for example, self-constructed property - made available) to the taxpayer or to some other person who will use the property for the benefit of the taxpayer. Further, the property must be capable, either alone or in combination with other property in the possession of the person to whom the property is delivered, of being used, by or for the benefit of the taxpayer or the other person, to produce a commercially saleable product or to perform a commercially saleable service.

This amendment applies to property acquired after 1989.

Clause 8

Eligible Capital Property

ITA
14

Section 14 of the Act provides rules concerning the tax treatment of expenditures and receipts of a taxpayer in respect of eligible capital properties. These rules operate on a "pooling basis". Annual deductions, which are calculated as a percentage of this pool, may be claimed under paragraph 20(1)(b).

Subclause 8(1)

ITA
14(1)(a)(v)

Paragraph 14(1)(a)(v) of the Act includes in the business income of a taxpayer what could be considered to be the taxable portion of gains arising on the disposition of eligible capital property in the year. The postamble to that paragraph also provides that, for the purposes of section 110.6 and paragraph 3(b) as it applies for that section, the portion of those gains attributable to dispositions of qualified farm properties will be considered to be a taxable capital gain of the taxpayer from the disposition in the year of qualified farm property.

Paragraph 14(1)(a)(v) is amended, applicable to fiscal periods ending after February 22, 1994, otherwise than solely because of an election under subsection 25(1) of the Act, to eliminate the postamble of the provision as a consequence of the introduction of new subsection 14(1.1).

Subclause 8(2)

ITA
14(1.1)

New subsection 14(1.1) of the Act, which applies for fiscal periods ending after February 22, 1994, otherwise than solely because of an election under subsection 25(1) of the Act, will treat, for the purposes of section 110.6 and paragraph 3(b) as it applies for the purposes of that section, business income of a taxpayer for a year arising under paragraph 14(1)(a)(v) in respect of the sale of eligible capital property as a taxable capital gain from a disposition in the year of qualified farm property to the extent of the lesser of two amounts. The first amount is the amount included in the taxpayer's business income for the year under paragraph 14(1)(a)(v). The second amount is the excess of the taxable amount of the taxpayer's cumulative net gains from the disposition in the year or a preceding taxation year commencing after 1987 of qualified farm property that is eligible capital property in respect of the business over the amount of such taxable net gains that have already received the taxable capital gains treatment in previous years either under this new subsection or paragraph 14(1)(a) as it read in respect of fiscal periods ending before February 23, 1994. Net gains are measured as the excess of proceeds from such dispositions over the total of the costs of the properties disposed of and selling costs associated with such dispositions. Such taxable capital gains from the disposition of qualified farm property arising under new subsection 14(1.1) will be amounts in respect of which a taxpayer may be eligible to claim the capital gains deduction under subsection 110.6(2) of the Act.

Subclause 8(3)

ITA
14(6)

Subsection 14(6) of the Act provides a replacement property rule for eligible capital property. Under this rule, the recognition of a negative balance in the cumulative eligible capital account of a taxpayer at the end of a taxation year, arising as a consequence of a disposition, may be deferred where the taxpayer acquires a replacement eligible capital property before the end of the taxation year following the year of disposition.

This amendment to subsection 14(6) is consequential on the amendment of subsection 14(7) of the Act. Generally, the condition in subsection 14(6) requiring a taxpayer to acquire a property as a replacement for the taxpayer's former property is transferred to subsection 14(7). For additional details see the commentary on the amendments to that subsection.

This amendment applies to dispositions of former properties occurring after the 1993 taxation year.

Subclause 8(4)

ITA
14(7)

Subsection 14(7) of the Act describes the conditions under which an eligible capital property acquired by a taxpayer will be a replacement property for the purposes of subsection 14(6) of the Act.

Subsection 14(7) is amended in two ways. First, new paragraph 14(7)(a) provides that a particular eligible capital property of a taxpayer will not be considered to be a replacement property unless it is reasonable to conclude that the property was acquired by the taxpayer to replace the former property. Second, former paragraph 14(7)(a) becomes new paragraph 14(7)(a.1). For additional details see the commentary on the amendments to subsections 13(4) and (4.1) and subsections 44(1) and (5).

This amendment applies to dispositions of former properties occurring after the 1993 taxation year.

Subclause 8(5)

ITA
14(12) and (13)

New subsection 14(12) applies where a corporation, trust or partnership has disposed of eligible capital property and would, but for this new rule, have been entitled as a consequence of the disposition to claim a deduction under subsection 24(1) for any undeducted amounts remaining in its cumulative eligible capital pool in respect of that business. (In general terms, subsection 24(1) would ordinarily permit such a deduction where the taxpayer has ceased to carry on the business and no longer owns any eligible capital property of value with respect to that business.) Where (1) these conditions exist, (2) the transferor or a person "affiliated" with the transferor acquires an identical property or the transferred property itself (either of which is termed the "substituted property") within the period beginning 30 days before and ending 30 days after the disposition, and (3) the transferor or an affiliated person owns the property at the end of that period, no deduction may be recognized on the transfer. Instead, such a deduction is deferred until the earliest of the following events:

- a subsequent disposition of the property to a person that is neither the transferor nor a person affiliated with the transferor (provided that for 30 days after that subsequent disposition neither the transferor nor an affiliated person owns either the substituted property or an identical property acquired after the beginning of the period described above);

- a change whereby the property no longer constitutes eligible capital property of a business of the transferor or an affiliated person;

- a "deemed disposition" of the property under section 128.1 (change of residence) or subsection 149(10) (change of taxable status);

- in the case of a corporation, an acquisition of the corporation's control; or

- where the transferor is a corporation, a winding-up of the transferor (other than a winding-up under subsection 88(1) of the Act).

If subsection 14(12) applies, the transferor will be treated as continuing to own eligible capital property of the business in respect of which the transferred property was used. This will enable the transferor to continue to claim annual cumulative eligible capital amounts under paragraph 20(1)(b) in respect of the remaining eligible capital property pool, and to claim a loss for any portion of the pool that remains undeducted when any of the events described above occurs.

New subsection 14(12) replaces subsection 85(4) of the Act, insofar as subsection 85(4) applied to transfers of eligible capital property. Subsection 85(4) operated to the same effect in denying the recognition of a loss on the transfer of eligible capital property to persons such as a corporation controlled by the transferor. However, new subsection 14(12) differs from subsection 85(4) in two material respects. First, it does not apply to transfers by individuals other than trusts, but can, as a result of its adoption of the definition of "affiliated persons" in new section 251.1 of the Act (see the commentary on that section for a fuller description), apply to eligible capital property transfers to individuals, corporations and partnerships in cases where subsection 85(4) would not have applied. Second, the new rule does not add the denied deduction to the cost of any shares received by the transferor in exchange for the property but, instead, retains it in the transferor's hands to be amortized and (to the extent of any unamortized portion) deducted under subsection 24(1).

New subsection 14(13) of the Act provides two special rules for the purposes of the loss-deferral rule in new subsection 14(12). First, new paragraph 14(13)(a) sets out that a right to acquire a property (other than a right that is security for a debt or similar obligation) is treated as a property that is identical to the property. For example, if a corporation, partnership or trust disposes of an eligible capital property, and within the relevant period an affiliated person of the transferor acquires and holds an option to acquire either that property or an identical one, new subsection 14(12) will apply.

Second, new paragraph 14(13)(b) clarifies the result that obtains where a transferor partnership ceases to exist after a disposition but before any of the events that would trigger its recognition of the deferred loss. Where a partnership would otherwise cease to exist after a disposition to which new subsection 14(12) applies, the partnership is treated as not having ceased to exist, and each person who was a member of the partnership before it would otherwise cease to exist is treated as having remained a member of the partnership. This deemed continuation of the partnership (and of the membership of each partner) continues until the time that is immediately after the first of the events that trigger the partnership's loss.

New subsections 14(12) and (13) apply to dispositions of property that take place after April 26, 1995, subject to certain exceptions. These are found in clause 156, and generally exclude transactions in progress before April 27, 1995. Readers may refer to the notes to clause 156 for more detail.

Clause 9

Shareholder Benefits

ITA
15

Section 15 of the Act requires the inclusion in income of certain benefits received or enjoyed by a shareholder of a corporation.

Subclause 9(1)

ITA
15(2)

Subsection 15(2) of the Act requires that certain shareholder indebtedness be included in the income of the debtor in the year in which the indebtedness arose. Included in such indebtedness are loans from a corporation to its shareholders, loans to persons connected (non-arm's length) with the shareholders, as well as loans from a partnership to a shareholder of one of its corporate members. Paragraphs 15(2)(a) and (b) provide exceptions to this income inclusion rule for indebtedness arising in specific circumstances.

Subsection 15(2) is amended to clarify the rules that apply where loans are made to taxpayers who are both shareholders and employees of a corporation. This is accomplished by restructuring the subsection so that the basic rule for the taxation of shareholder loans is contained in amended subsection 15(2), while the exceptions to this basic rule are provided in new subsections 15(2.2) to (2.6) of the Act.

This amendment applies to loans made and indebtedness arising in the 1990 and subsequent taxation years.

Subclause 9(2)

ITA
15(2.2) to (2.6)

New subsection 15(2.2) of the Act excludes loans between non-resident persons from the application of subsection 15(2). This new subsection is a restatement of subsection 15(8) of the Act, which is being repealed.

New subsection 15(2.3) of the Act restates former subparagraph 15(2)(a)(i) which relates to loans made in the ordinary course of business.

New subsection 15(2.4) of the Act provides exceptions to the rule in subsection 15(2) in respect of certain loans made to shareholders who are also employees. Subject to new paragraphs 15(2.4)(e) and (f), new paragraph 15(2.4)(a) provides an exception for loans or indebtedness in respect of an employee who is not a specified employee of the lender or creditor, while new paragraphs 15(2.4)(b) and (c) (which restate former subparagraphs 15(2)(a)(ii) and (iii)) provide exemptions related to home and share acquisition loans. New paragraph 15(2.4)(d), which is broader in scope than former subparagraph 15(2)(a)(iv), provides an exemption related to motor vehicle acquisition loans.

New paragraph 15(2.4)(e) deals with loans made to and debts incurred by individuals who are both employees and shareholders. It provides that for a loan or indebtedness described in new paragraphs 15(2.4)(a) to (d) to be exempt from inclusion in income under subsection 15(2), the loan or indebtedness must be received or

incurred because of the employee's employment and not because of any person's shareholding.

New paragraph 15(2.4)(f) restates the former postamble to paragraph 15(2)(a). Paragraph 15(2.4)(f) provides that, for a loan or indebtedness described in new paragraph 15(2.4)(a) to (d) to be exempt from inclusion in income under subsection 15(2), bona fide arrangements must have been made for repayment of the loan or indebtedness.

New subsection 15(2.4) ensures that the exceptions formerly contained in subsection 15(2) (and now found in new paragraphs 15(2.4)(b), (c) and (d)), as well as the exception in new paragraph 15(2.4)(a), only apply where it is reasonable to conclude that the loan was made or the indebtedness arose because of the employee's employment and where there are bona fide arrangements for repayment.

New subsection 15(2.5) of the Act provides an exception to the income inclusion rule in subsection 15(2) for certain loans made by a private corporation to a trust where the corporation is the settlor and sole beneficiary of the trust, and the sole purpose of the trust is to facilitate the purchase and sale of the shares of the corporation, or a related corporation, from, or to, the employees (other than specified employees) of the corporation or the related corporation. The purchase and sale of the shares must take place at fair market value at the time of the transaction.

New subsection 15(2.6) of the Act, which provides that subsection 15(2) does generally not apply to a loan or indebtedness repaid within one year of its issue, is a restatement of former paragraph 15(2)(b) of the Act.

New subsections 15(2) to (2.6) of the Act generally apply to loans made or indebtedness arising in the 1990 and subsequent taxation years.

Subclause 9(3)

ITA
15(8)

Subsection 15(8) of the Act is repealed, applicable to loans made or indebtedness arising in the 1990 and subsequent taxation years, as its provisions are contained in new subsection 15(2.2) of the Act.

Subclause 9(4)

ITA
15(9)

Subsection 15(9) of the Act provides that where an amount in respect of a loan or debt is deemed by section 80.4 of the Act to be a benefit received by a person or partnership in a taxation year, the amount of the loan or debt is deemed for the purposes of subsection 15(1) to be a benefit conferred in the year on a shareholder. The words "of the loan or debt" were erroneously substituted for the word "thereof" in the English version of the Act by the Statute Revision Commission when the Commission revised the Act.

This amendment, therefore, clarifies that it is only the portion of the amount in respect of the loan or debt that is deemed to be a benefit under section 80.4 that is also deemed to be a benefit for the purposes of subsection 15(1) as opposed to the full amount of the loan or debt.

This amendment applies to taxation years that end after November 1991, as these are the taxation years to which the amendment made in the Fifth Supplement of the Revised Statutes of Canada, 1985 applies.

Clauses 10 and 11

Small Business Development Bonds

ITA
15.1 and 15.2

Sections 15.1 and 15.2 of the Act set out rules defining and governing the treatment of small business development bonds (SBDBs) and small business bonds (SBBs). SBDBs and SBBs are debt obligations on which any interest payable is not deductible to the issuer but is instead treated as a taxable dividend to the recipient.

The amendments to subsections 15.1(3) and 15.2(3), which apply after April 26, 1995, are consequential on the adoption in subsection 248(1) of the Act of a definition of the term "majority interest partner". The definition of that term was formerly found in subsection 97(3.1) and adopted by reference in sections 15.1 and 15.2. The new definition in subsection 248(1) applies for the purposes of the Act and thus allows the definition of that term in subsection 15.1(3) and 15.2(3) to be repealed.

Clause 12

Disallowed Deductions

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 12(1)

Penalties, bonuses and rate-reduction payments

ITA
18(9.1)

Subsection 18(9.1) of the Act applies where a penalty or bonus is paid in respect of the repayment of all or part of a debt obligation before its maturity. The subsection provides, in certain circumstances, that the penalty or bonus is deemed to have been paid and received as

interest, to the extent that it does not exceed the future interest that would, but for the repayment, have been payable on the obligation. Subsection 18(9.1) also applies with respect to certain interest rate reduction payments.

Subsection 18(9.1) is amended to provide that it is subject to new subsection 142.4(10). That subsection provides that a penalty or bonus received by a financial institution in respect of the early repayment of all or part of the principal amount of a specified debt obligation is considered to be received by the institution as proceeds of disposition.

This amendment applies to taxation years that end after February 22, 1994.

Subclause 12(2)

ITA
18(13) to (16)

Existing subsection 18(13) denies the recognition of superficial losses sustained by a taxpayer whose ordinary business includes the lending of money. A superficial loss under subsection 18(13) is a loss realized by a taxpayer on the sale or transfer of a property (other than a capital property) such as a share or a bond where the same or identical property (referred to as "substituted property") is acquired by the taxpayer or a non-arm's length person or partnership during the period beginning 30 days before and ending 30 days after the disposition, and is held by the taxpayer or the person or partnership at the end of that period. Currently, any superficial loss with respect to the disposition is added in computing the cost to the owner of the substituted property. This rule is similar to the superficial loss rule in paragraph 54 of the Act that applies for the purposes of computing capital gains and losses.

With the addition of new subsection 18(14) of the Act, the structure of subsection 18(13) is modified. Subsections 18(13) and (14), respectively, now set out the conditions under which certain losses of money lenders and adventurers in trade are deferred. New subsection 18(15) describes the loss deferral itself.

While these amendments to subsection 18(13) maintain the provision's original objective of denying the recognition of superficial losses, they do make two material changes. First, any loss that would otherwise be deductible with respect to a property is no longer added to the cost of that property to its subsequent owner. Instead, that loss is preserved in the transferor's hands and will be deductible by the transferor upon the first occurrence of any of the following events:

- a subsequent disposition of the property to a person that is neither the transferor nor a person affiliated with the transferor (provided that for 30 days after that subsequent disposition neither the transferor nor an affiliated person owns either the substituted property or an identical property acquired after the beginning of the period described above);
- a "deemed disposition" of the property under section 128.1 (change of residence) or subsection 149(10) (change of taxable status);
- in the case of a corporation, an acquisition of the corporation's control; or
- where the transferor is a corporation, a winding-up of the transferor (other than a winding-up under subsection 88(1) of the Act).

Second, subsection 18(13) no longer sets out its own description of the group of persons and partnerships whose connection with a taxpayer would render any loss on the transfer of property by the taxpayer to a member of that group a superficial loss. As amended, the subsection will apply where the taxpayer is "affiliated" with the transferee – using the tests set out in new section 251.1 of the Act. (See the commentary to section 251.1 for further information.)

The closing words of subsection 18(15) clarify the result that obtains where a transferor partnership ceases to exist after a disposition that is subject to subsection 18(15), but before any of the events that would trigger recognition of the deferred loss. Where a partnership would otherwise cease to exist after a disposition to which subsection 18(15) applies, the partnership is treated as not having ceased to exist, and each person who was a member of the partnership before it would otherwise cease to exist is treated as

having remained a member of the partnership. This deemed continuation of the partnership (and of the membership of each partner) continues until the time that is immediately after the first of the events that trigger the partnership's loss.

New subsection 18(16) sets out that a right to acquire a property (other than a right that is security for a debt or similar obligation) is treated for the purposes of subsections 18(13) to (15) as a property that is identical to the property.

Amended subsection 18(13) applies to dispositions that take place after April 26, 1995, subject to three exceptions. Two of these are found in clause 156, and generally exclude transactions in progress before April 27, 1995. Readers may refer to the notes to clause 156 for more detail. The third exception is that amended subsection 18(13) does not apply to a disposition that occurred before July 1995, where subsection 142.6(7) of the Act does not apply but would apply if the disposition had occurred after June 1995. This conforms this amendment to the coming-into-force of subsection 142.6(7).

New subsection 18(14) applies to dispositions of property that occur after ANNOUNCEMENT DATE, other than a disposition that occurs before 1997 to a person or partnership that was obliged on ANNOUNCEMENT DATE to acquire the property pursuant to the terms of an agreement in writing made on or before that day. For the purposes of this subsection, a person or partnership shall be considered not to be obliged to acquire property where the person or partnership can be excused from the obligation is there is a change to the Act or if there is an adverse assessment under the Act.

New subsections 18(15) and (16) apply to dispositions that occur after April 26, 1995.

Clause 13

Income from 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 business or property.

Subclause 13(1)

Expenses re: financing

ITA
20(1)(e)

Paragraph 20(1)(e) of the Act provides for the deduction over a five-year period of expenses incurred in issuing securities, borrowing money and rescheduling or restructuring debt obligations. These expenses include commissions, fees and other amounts payable to agents and salespersons, but do not include amounts described in paragraph 18(9.1)(c) or (d) of the Act which are deductible under paragraph 20(1)(c). Paragraph 20(1)(e) is amended, applicable to expenses incurred after 1987, to remove the reference to amounts described in paragraph 18(9.1)(c)or (d). This reference is not necessary because paragraph 20(1)(e) only provides a deduction for amounts not otherwise deductible in computing income from a business or property under the Act.

Subclauses 13(2) and (3)

Reserve for doubtful debts

ITA
20(1)(l)

Paragraph 20(1)(l) of the Act permits a taxpayer that is an insurer or whose ordinary business includes the lending of money to claim a reserve in respect of doubtful loans or lending assets. A taxpayer whose ordinary business is not the lending of money but the

purchasing of debt obligations issued by arm's length persons cannot claim a doubtful debt reserve. Instead, such a taxpayer can use the inventory accounting rules to obtain a current deduction in respect of a debt obligation that has become doubtful and fallen in value.

Under the new mark-to-market rules, a taxpayer is a financial institution if the taxpayer's ordinary business is the purchasing of debt obligations. As a financial institution, the taxpayer is deemed not to hold as a property in inventory any debt obligation that is a specified debt obligation. To replace an affected taxpayer's lost inventory accounting deduction, the amendment to paragraph 20(1)(l) broadens the paragraph's application to provide such taxpayers with a current deduction in respect of specified debt obligations that have become doubtful and fallen in value. The amendment applies to taxation years that end after February 22, 1994.

The maximum reserve a taxpayer can claim in respect of a loan or lending asset is equal to the sum of a prescribed reserve amount under clause 20(1)(l)(ii)(A) in respect of certain loans and lending assets and an amount determined under clause 20(1)(l)(ii)(B) in respect of other doubtful loans and lending assets. The amount under clause 20(1)(l)(ii)(B) is based on the lesser of two amounts, one of which is the reserve reported in the taxpayer's financial statements. For this purpose, the financial statement reserve is increased by the amount of interest included by subsection 12(3) of the Act in the taxpayer's income, to the extent that the interest has reduced the reserve. This addition to the reserve recognizes that some taxpayers such as banks are required to apply interest payments received on a doubtful loan or lending asset towards reducing the reserve taken in respect of that loan or lending asset.

Sub-subclause 20(1)(l)(ii)(B)(II)2, which specifies the amount to be added to the financial statement reserve, is amended so that it also applies with respect to interest included in a taxpayer's income by paragraph 142.3(1)(a). This amendment is consequential on the introduction of the new rules for debt obligations held by financial institutions. It applies to taxation years that end after February 22, 1994.

Subclause 13(4)

Reserve for bad debts

ITA
20(1)(p)

Paragraph 20(1)(p) of the Act permits a taxpayer that is an insurer or whose ordinary business includes the lending of money to deduct an amount in respect of loans or lending assets established by the taxpayer to have become uncollectable in the year.

A taxpayer whose ordinary business is not the lending of money but the purchasing of debt obligations issued by arm's length persons cannot claim a bad debt reserve. Instead, such a taxpayer can use the inventory accounting rules to obtain a current deduction in respect of a debt obligation that has become uncollectable.

Under the new mark-to-market rules, a taxpayer is a financial institution if the taxpayer's ordinary business is the purchasing of debt obligations. As a financial institution, the taxpayer is deemed not to hold as a property in inventory any debt obligations that is a specified debt obligation. To replace an affected taxpayer's lost inventory accounting deduction, the amendment to paragraph 20(1)(p) broadens the paragraph's application to provide such taxpayers with a current deduction in respect of uncollectable specified debt obligations. The amendment applies to taxation years that end after February 22, 1994.

Clause 14

Crown Corporations

ITA
27(1)

Section 27 of the Act provides special rules for the application of Part I of the Act to federal Crown corporations.

Section 27 allows the Governor in Council to impose income tax on a federal Crown corporation by prescribing the corporation in the

Income Tax Regulations. Where the prescribed corporation is a Crown agent, subsection 27(1) treats any income it earns or loss it incurs as its own income or loss, rather than Her Majesty's. This provision is amended in two respects. First, the rule is broadened to apply to all federal Crown corporations, not only those that have been prescribed. This does not impose tax on a corporation that has not been prescribed, but it does ensure that such a corporation's income or loss is appropriately measured when, for example, it ceases to be exempt from tax and is subject to the rules in subsection 149(10) of the Act.

The second change to subsection 27(1) provides that not only business and property income, but also the ownership of property itself, is attributed to the corporation. New paragraph 27(1)(b) specifies that Part I applies as though any property, obligation or debt of any kind held, administered, entered into or incurred by a prescribed federal Crown corporation as a Crown agent were instead a property, obligation or debt of the corporation itself. This ensures, for example, that capital gains and losses realized in respect of Crown property it administers are included in computing a Crown corporation's income.

For most purposes, this amendment applies to taxation years that begin after April 26, 1995. There are, however, certain exceptions. Amendments to Parts I.3, IV.1, VI and VI.1 of the Act provide that section 27 applies to those Parts. For those purposes, the amendment applies as of the dates those parts themselves took effect.

Clause 15

Farming or Fishing Business

ITA
28(1)

Section 28 of the Act provides rules concerning the computation of income for farmers and fishermen who use the cash method of accounting for income tax purposes.

Paragraph 28(1)(d) is amended to eliminate the reference in the paragraph to subsection 80(17), strictly as a consequence of the repeal of that subsection.

This amendment applies to taxation years that end after February 21, 1994.

Paragraph 28(1)(e) is amended to provide that payments (other than for inventory) that reduce cash-basis income of a farming or fishing business for a year do not include prepaid expenses relating to a taxation year of the business that is two or more taxation years after the year of payment.

New paragraph 28(1)(e.1) provides a deduction in a taxpayer's taxation year for amounts paid in a previous taxation year by the taxpayer where the amounts would be deductible in computing income for the current taxation year from the taxpayer's business of farming or fishing if that income were not computed in accordance with the cash method. To be deductible by a taxpayer, the amount is required to have been paid by the taxpayer in a preceding taxation year in the course of carrying on the business of farming or fishing and cannot be deductible in computing the income of the business for any other taxation year.

Amended paragraph 28(1)(e) and new paragraph 28(1)(e.1) apply to amounts paid after April 26, 1995 except amounts paid pursuant to written agreements made by the payer on or before April 26, 1995.

Clause 16

Scientific Research and Experimental Development

ITA
37

Section 37 of the Act sets out the rules for the deduction of expenditures incurred by a taxpayer on scientific research and experimental development (SR&ED) performed both inside and outside Canada.

Subclause 16(1)

ITA
37(1)

Subsection 37(1) of the Act provides that a taxpayer may deduct from the taxpayer's business income in respect of a taxation year certain amounts expended for SR&ED. Subparagraph 37(1)(a)(iii) allows the deduction of payments made by the taxpayer to a corporation resident in Canada and exempt from tax because of paragraph 149(1)(j) of the Act where certain conditions are met. That subparagraph applies only where the taxpayer is a corporation. However, an amendment was made to the French version of that provision when the statute that introduced that provision into the Act (that is, S.C. 1991, c. 49) was revised by the Statute Revision Commission in chapter 7 of the Statutes of Canada, 1994 (Schedule II). The expression "société de personnes" was then erroneously substituted for the word "corporation". This amendment substitutes the word "société" for the expression "société de personnes".

This amendment applies to taxation years that end after November 1991, as these are the taxation years to which the amendment made to subparagraph 37(1)(a)(iii) in the Fifth Supplement of the Revised Statutes of Canada, 1985 applies.

Subclause 16(2)

ITA
37(10)

Subsection 37(10) of the Act requires that an election made by a taxpayer under clause 37(8)(a)(ii)(B) in respect of SR&ED incurred in a taxation year be filed with the taxpayer's Part I return of income for that year. Subsection 37(10) is amended as a consequence of the new filing requirements in subsection 37(1). Under amended subsection 37(10), the taxpayer must file the election made under clause 37(8)(a)(ii)(B) for a taxation year at the time the taxpayer first files a prescribed form under subsection 37(1) for the year. Subject to transitional relief, new subsection 37(10) applies after February 21, 1994.

Clause 17

Scientific Research and Experimental Development - Additional Allowance

ITA
37.1 to 37.3

Section 37.1 of the Act provides an additional deduction for expenditures in respect of scientific research and experimental development carried on in Canada by a corporation. This has generally not been available since 1983. Subsection 37.1(3) of the Act, however, continues to require the recapture of this allowance for current dispositions of "research property" notwithstanding the research property may not have earned the additional allowance. Section 37.1, as well as sections 37.2 and 37.3, which are application sections in respect of section 37.1, are repealed for the 1995 and subsequent taxation years.

Clause 18

Exempt capital gains balance

ITA
39.1(1)

The exempt capital gains balance of an individual for a taxation year in respect of a flow-through entity represents the unclaimed balance of the capital gains that were included in computing the individual’s income as a result of elections made under subsection 110.6(19) in respect of the individual’s interest in, or shares of the capital stock of, the entity.

An individual’s exempt capital gains balance in respect of a flow-through entity for a taxation year is reduced by amounts claimed in previous years under subsections 39.1(2) to (6) to reduce capital gains otherwise determined on dispositions of interests in, or shares of the capital stock of, the entity or taxable capital gains or capital gains flowed out to the individual by the entity.

The definition "exempt capital gains balance" is amended, applicable to the 1994 and subsequent taxation years, to provide that an individual's exempt capital gains balance in respect of a flow-through entity for a taxation year is also reduced by amounts included in the description of the new variable "F" included in the formula in this definition. This amendment is relevant in respect of flow-through entities that are trusts described in paragraphs (g) to (j) of the definition of "flow-through entity" in subsection 39.1(1). These trusts are:

- certain trusts governed by employees profit sharing plans,
- certain trusts created to hold shares of the capital stock of corporations for the benefit of their employees,
- certain trusts established for the benefit of creditors to secure certain debt obligations, and
- certain voting trusts where the purpose of the trust is to provide for the exercise of voting rights attached to shares held by the trust.

As a result of this amendment, where the flow-through entity is a trust described in paragraphs (g) to (j) of the definition of "flow-through entity" and the trust distributed property in a previous year to the individual in satisfaction of all or a portion of the individual's interests in the trust, the variable "F" will reduce the individual's exempt capital gains balance in respect of the trust for the year by the total of all amounts included in the cost of the property to the individual because of elections by the individual under new subsection 107(2.2) or new paragraph 144(7.1)(c). (For further information, reference may be made to the commentary on new subsection 107(2.2) and new paragraph 144(7.1)(c))

Clause 19

Capital Gains and Losses - General Rules

ITA
40

Section 40 of the Act provides rules for determining an individual's capital gain or capital loss for a taxation year arising from the disposition of property.

Subclause 19(1)

ITA
40(2)(e)

Paragraph 40(2)(e) of the Act provides that a corporation's loss with respect to property disposed of by it to a person that controls the corporation, or to another corporation controlled by the same person that controls the first corporation, is nil. The circumstances to which paragraph 40(2)(e) may have previously applied will be covered by new subsection 40(3.3). Paragraph 40(2)(e) is therefore repealed with the coming-into-force of new subsection 40(3.3).

Subclause 19(2)

ITA
40(2)(h)(i)

Paragraph 40(2)(h) of the Act provides for certain adjustments to a taxpayer's loss otherwise determined from the disposition of shares of the capital stock of a corporation that was controlled by the taxpayer at any time in the taxpayer's taxation year in which the disposition occurred. The amendment to this paragraph simply clarifies that a corporation's loss from the disposition of a controlled corporation's shares is subject to adjustment to take account of previous dispositions of property by the controlled corporation to any other corporation, including the shareholder corporation. The coming-into-force of this amendment is the same as that of new subsections 40(3.3) to (3.6) of the Act.

Subclause 19(3)

ITA
40(3.1)

Subsection 40(3.1) of the Act provides that a member of a partnership is considered to have realized a gain equal to the "negative adjusted cost base" of the members' interest at the end of the fiscal period if the member is a limited partner or was since becoming a partner, a "specified member of the partnership". The English version of this provision is restructured so as to clarify any ambiguity in its application. Generally, this amendment applies after February 21, 1994.

Subclause 19(4)

ITA
40(3.13)

New subsection 40(3.13) of the Act provides an anti-avoidance rule that applies where one of the main reasons that a member of a partnership was not a specified member of the partnership since becoming a member of the partnership is to avoid the application of the "negative" adjusted cost base rule in subsection 40(3.1) of the Act.

In such cases, the member will be considered, for the purpose of subsection 40(3.1), to have been a specified member of the partnership at all times since becoming a member of the partnership. This subsection applies after April 26, 1995.

Subclause 19(5)

ITA
40(3.14)(b)

Subsection 40(3.14) of the Act provides an extended definition of "limited partner" for the purpose of determining whether a member's interest in a partnership is subject to the negative adjusted cost base rule in subsection 40(3.1) of the Act.

Paragraph 40(3.14)(b) is clarified to ensure that it applies where a member of a partnership, or a person not dealing at arm's length with the member, is entitled to receive certain amounts or obtain certain benefits referred to in paragraph 96(2.2)(d) of the Act, either immediately or in the future and either absolutely or contingently. This amendment applies to fiscal periods that end after November 1994.

Subclause 19(6)

Loss on certain transfers

ITA
40(3.3) and (3.4)

New subsections 40(3.3) and (3.4) of the Act set out rules that defer losses on certain dispositions of non-depreciable capital property. Under new subsection 40(3.3), these rules apply where (1) a corporation, trust or partnership has disposed of a non-depreciable capital property, (2) the transferor or a person "affiliated" with the transferor acquires the transferred property or an identical property (either of which is termed the "substituted property") during the period that begins 30 days before and ends 30 days after the disposition, and (3) at the end of that period, the transferor or an affiliated person owns the substituted property.

Where these conditions are met, new subsection 40(3.4) provides that no loss may be recognized on the transfer. Instead, any loss is deferred until the earliest of the following events:

- a subsequent disposition of the property to a person that is neither the transferor nor a person affiliated with the transferor (provided that for 30 days after that later disposition neither the transferor nor an affiliated person owns the substituted property or an identical property acquired after the beginning of the 61-day period described above);

- a deemed disposition of the property under section 128.1 of the Act (change of residence) or subsection 149(10) of the Act (change of taxable status);

- in the case of a corporation, an acquisition of the corporation's control;

- where the substituted property is a debt or a share, a deemed disposition under section 50 of the Act; or

- where the transferor is a corporation, a winding-up of the transferor (other than a winding-up to which subsection 88(1) applies).

The closing words of new subsection 40(3.4) clarify the result where a transferor partnership ceases to exist after a disposition, but before any of the events that would trigger recognition of the deferred loss. Where a partnership would otherwise cease to exist after a disposition to which subsection 40(3.4) applies, the partnership is treated for the purposes of paragraph 40(3.4)(b) as not having ceased to exist, and each person who was a member of the partnership at the time of the disposition is treated as having remained a member of the partnership. This deemed continuation of the partnership (and of the membership of each partner) continues until the time that is immediately after the first of the events that trigger the partnership's loss.

New subsections 40(3.3) and (3.4) replace subsection 85(4) of the Act, insofar as subsection 85(4) applied to transfers of non-depreciable capital property. Subsection 85(4) operated to the same effect in denying the recognition of a loss on the transfer of such property to persons such as a corporation controlled by the transferor or a person that controlled the transferor. However, these new subsections differ from subsection 85(4) in two material respects. First, they do not apply to transfers by individuals other than trusts, but can, as a result of the adoption of the definition of "affiliated persons" in new section 251.1 of the Act (see the commentary on that section for a fuller description), have application to transfers of non-depreciable capital property transferred to individuals, corporations and partnerships in cases where subsection 85(4) would not have applied.

Second, the denied loss is not added to either to the cost of any shares held by the transferor in the transferee after the disposition, or to the cost to the transferee of the transferred property. Instead, the loss is preserved in the transferor's hands to be deducted as a loss from the transferred property when it is no longer owned by an

affiliated person, when it is deemed to have been disposed of under other provisions of the Act, or when control of a corporate transferor is acquired. (An exception arises in the case of shares of a corporation's capital stock that are disposed of to that corporation. See new subsection 40(3.6).)

New subsection 40(3.3) and (3.4) apply to dispositions of property that take place after April 26, 1995, subject to certain exceptions. These are found in clause 156, and generally exclude transactions in progress before April 27, 1995. Readers should refer to the notes to clause 156 for more detail.

Deemed identical property

ITA
40(3.5)

New subsection 40(3.5) of the Act sets out three special rules that apply for the purposes of the loss deferral rule in new subsection 40(3.4) of the Act. First, paragraph 40(3.5)(a) provides that a right to acquire a property (other than a right that is security for a debt or similar obligation) is treated for the purposes of subsection 40(3.5) as a property that is identical to the property. Second, paragraph 40(3.5)(b) treats a share that is acquired in exchange for another share under any of sections 51, 85.1, 86 or 87 of the Act as identical to that other share. Finally, paragraph 40(3.5)(c) clarifies the result where the property that gives rise to a deferred loss under new subsection 40(3.4) is a share of a corporation that is subsequently wound up into its parent under subsection 88(1) of the Act. In such a case, the parent corporation is treated as continuing to own the share as long as the parent is affiliated with the transferor.

New subsection 40(3.5) comes into effect on the same basis as new subsections 40(3.3) and (3.4).

Loss on shares

ITA
40(3.6)

Although new subsection 40(3.4) applies to most dispositions of non-depreciable capital property to affiliated persons, new subsection 40(3.6) of the Act applies special rules where the property is a share of the capital stock of a corporation and is disposed of to that corporation. Provided that the corporation acquiring its own shares is affiliated with the shareholder immediately after the acquisition, any loss that would otherwise arise with respect to the transaction is denied and the amount of that loss is instead added by paragraph 40(3.6)(b) to the adjusted cost base to the shareholder of other shares owned by it in the acquiring company.

New subsection 40(3.6) applies to dispositions that take place after April 26, 1995, subject to certain exceptions. These are found in clause 156, and generally exclude transactions in progress before April 27, 1995. Readers should refer to the notes to clause 156 for more detail.

Subclause 19(7)

ITA
40(9)

As a result of changes to the definition of "taxable Canadian property" in paragraph 115(1)(b) of the Act, certain properties acquired before April 26, 1995 will have become taxable Canadian properties on that date. New subsection 40(9) of the Act sets out a rule for computing a taxpayer's gain or loss on such a property. The rule prorates the amount of the gain or loss determined without reference to the subsection, according to the number of months the taxpayer held the property before May 1995.

New subsection 40(9) applies after April 26, 1995.

Clause 20

Exchanges of Property

ITA
44

Section 44 of the Act allows a taxpayer to defer the recognition of a capital gain on property under certain conditions.

Subclause 20(1)

ITA
44(1)

Subsection 44(1) of the Act allows a taxpayer who realizes a capital gain on the disposition of certain property to defer the gain to the extent that the taxpayer reinvests the proceeds of disposition in a replacement property within a certain period of time.

This amendment to subsection 44(1) is consequential on the amendments to subsection 44(5) of the Act. Generally, the condition in subsection 44(1) requiring a taxpayer to acquire a property as a replacement for the taxpayer's former property, is transferred to subsection 44(5). For additional details see the commentary on the amendments to subsection 44(5).

This amendment applies to dispositions of former properties that occur after the 1993 taxation year.

Subclause 20(2)

ITA
44(5)

Subsection 44(5) of the Act describes the conditions under which a capital property acquired by a taxpayer will be a replacement property for the purposes of subsection 44(1) of the Act.

Subsection 44(5) is amended in two ways. First, new paragraph 44(5)(a) provides that a particular property will not be considered to be a replacement property unless it is reasonable to

conclude that the property was acquired by the taxpayer to replace the former property.

Second, former paragraph 44(5)(a), which is new paragraph 44(5)(a.1), is clarified to refer to the acquired property being "used by the taxpayer or a person related to the taxpayer" for the same or a similar use to which the taxpayer or a person related to the taxpayer put the former property. A property acquired by a taxpayer is not necessarily denied replacement property treatment simply because it is used by a related person rather than by the taxpayer. This can occur, for example, where a taxpayer rents the acquired property to a related person who uses it in the same or similar business. For additional details, see the commentary on the amendments to subsections 13(4) and (4.1) and subsections 14(6) and (7).

These amendments apply to dispositions of former properties occurring after the 1993 taxation year.

Clause 21

Gain when Small Business Corporation Becomes Public

ITA
48.1(1)(a)(ii)

Section 48.1 of the Act allows the owner of qualified small business corporation shares to use the capital gains exemption under subsection 110.6(2.1) of the Act in respect of those shares when the corporation becomes a public corporation because its shares are listed on a prescribed stock exchange in Canada. Such a shareholder may elect to be treated as having disposed of the shares immediately before the change in the corporation’s status, in order to realize all or any part of any latent capital gain on the shares. The shareholder is then treated as having reacquired the shares at a cost equal to their deemed proceeds of disposition.

Subsection 48.1(1) is amended as a consequence of a change in the definition of "Canadian-controlled private corporation" (CCPC) in subsection 125(7) of the Act. In order to be a small business corporation as defined in subsection 248(1) of the Act, a corporation

must, among other things, be a CCPC. Since the revised CCPC definition will deny CCPC status not only to any corporation any of the shares of which are listed on a Canadian exchange, but also one with shares listed on a foreign exchange, such a corporation will no longer qualify as a small business corporation, and its shares will no longer be eligible for the capital gains exemption. The amended version of subparagraph 48.1(1)(a)(ii) of the Act ensures that the election under section 48.1 is available in such a case.

Not only will shareholders of corporations that are newly listed on prescribed Canadian or foreign exchanges be able to make the election, but also those whose corporations were already listed on foreign exchanges on January 1, 1996, when the revised CCPC definition takes effect. If a corporation's shares were listed on that date, and the corporation was a small business corporation on December 31, 1995, an election under section 48.1 will be treated as having been made in a timely manner provided it is made before the end of the third month following the month in which this amendment receives Royal Assent.

Clause 22

Convertible property

ITA
51(1)

Section 51 of the Act generally permits a tax-deferred transfer of property where a taxpayer exchanges capital property that is a share or a convertible bond, debenture or note of a corporation for capital property that is another share of the capital stock of the corporation. This subsection is amended to ensure that the exchange is made with the corporation and not with another shareholder of the corporation. This amendment applies to exchanges that occur after ANNOUNCEMENT DATE other than exchanges that occur before 1997 pursuant to agreements in writing made on or before ANNOUNCEMENT DATE.

Clause 23

Cost of shares to subsidiary

ITA
52(7)

Section 52 of the Act sets out rules for determining the cost of certain property for the purposes of measuring any gain or loss on its disposition. Subsection 52(7) applies where a corporation disposes of Canadian branch property to its subsidiary wholly-owned corporation under special rules provided in Part XIV of the Act. This provision is amended, as a consequence of changes to Part XIV, to update its reference to subsection 219(1) of the Act and to extend to dispositions other than those to subsidiary wholly-owned corporations. For more information on the transfers to which subsection 52(7) applies, readers should consult the notes to amended subsection 219(1).

This amendment applies to taxation years that begin after 1995.

Clause 24

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.

Subclauses 24(1) and (2)

ITA
53(1)(f.1), (f.11) and (f.2)

Paragraph 53(1)(f.1) of the Act provides for an increase in computing the adjusted cost base to a taxable Canadian corporation of property transferred to the corporation, equal to the capital loss denied to the transferor because of paragraphs 40(2)(e) or (e.1) or subsection 85(4)

of the Act. Paragraph 53(1)(f.11) provides that a capital loss denied under paragraph 40(2)(e.1) on the transfer of a property is, to the extent that it is not reflected under paragraph 53(1)(f.1), similarly added to the adjusted cost base to the transferee of the property. Paragraph 53(1)(f.2) simply records within subsection 53(1) the adjusted cost base addition provided under paragraph 85(4)(b) – that is, where subsection 85(4) applies to deny a loss on a disposition of property to a corporation and instead adds the amount of the loss to the cost to the transferor of shares in the corporation.

The amendments to these paragraphs limit the application of references to paragraphs 40(2)(e) and subsection 85(4) to cases in which the property in question was acquired before 1996, reflecting the repeal of those provisions with respect to property acquired after 1995. In addition, paragraph 53(1)(f.2) is amended to add a reference to new paragraph 40(3.6)(b), described above in commentary relating to amendments to section 40 of the Act.

Subclause 24(3)

ITA
53(1)(r)

New paragraph 53(1)(r) of the Act is added consequential on the elimination of the $100,000 lifetime capital gains exemption for gains that are realized after February 22, 1994 and the introduction of the mechanism in subsection 110.6(19) for recognizing gains accrued to the end of that day. Where an individual recognizes a capital gain accrued to that time on an interest in, or a share of the capital stock of, a flow-through entity (as defined in subsection 39.1(1)), the amount of the gain is credited to a special account referred to as the individual’s exempt capital gains balance in respect of the entity. Claims may be made against this account to reduce gains that are flowed out to the individual by the entity for taxation years that end before 2005 and gains realized on dispositions of interests in or shares of the entity for those years.

New paragraph 53(1)(r) increases an individual’s adjusted cost base of each interest in, or share of the capital stock of, a flow-through entity described in any of paragraphs (a) to (f) of the flow-through entity definition by a pro rata portion of the amount of the individual’s unused exempt capital gains balance in respect of the

entity where the individual disposes of all interests in and shares of the capital stock of the entity. For the purpose of determining the unused portion of the individual's exempt capital gains balance in respect of the entity, the balance for the year is reduced by the total of the total of all reductions in the year in capital gains because of the balance and 4/3 of the total of all reductions in the year in taxable capital gains or business income because of the balance that arise because of dispositions by the individual or because of dispositions by the entity that are flowed out to the individual.

New paragraph 53(1)(r) will benefit individuals in circumstances in which interests in or shares of a flow-through entity have declined in value since February 22, 1994. New paragraph 53(1)(r) is available only in respect of dispositions before 2005. After 2004, paragraph 53(1)(p) increases the adjusted cost base of the individual's remaining interests in, or shares of the capital stock of, a flow-through entity by the unused portion of the individual's exempt capital gains balance in respect of the entity at that time.

New subsection 53(1)(r) applies to the 1994 and subsequent taxation years.

Subclause 24(4)

ITA
53(2)(c)(i)(C)

Subparagraph 53(2)(c)(i) of the Act reduces a taxpayer's adjusted cost base of a partnership interest by the taxpayer's share of losses of the partnership that are not included in the taxpayer's limited partnership losses. Clause 53(2)(c)(i)(C) provides that any loss of the partnership is to be determined without reference to subsections 112(3.1) and (4.2) of the Act. Under those subsections, a taxpayer's share of a partnership loss from the disposition of corporate shares can be reduced by certain dividends received by the taxpayer on the shares. Clause 53(2)(c)(i)(C) is amended in two respects.

First, the reference to subsection 112(4.2) is changed to a reference to subsection 112(4.2) as it read in its application to dispositions of property before April 27, 1995. This modification is necessary because, effective for dispositions of property after April 26, 1995, amended subsection 112(4.2) does not apply to partnership losses.

Second, the clause is amended consequential upon the amendment to subsection 100(4) of the Act which provides that a loss from the disposition of an interest in the partnership may be reduced where the interest is held by another partnership. Amended clause 53(2)(c)(i)(C) provides that in computing a taxpayer's adjusted cost base of an interest in the partnership which disposed of the interest in the other partnership, the loss arising from the disposition is to be determined without reference to the loss reduction under subsection 100(4). Therefore, the full amount of any loss arising from the disposition of an interest in a partnership is taken into account in computing the adjusted cost base of a partnership interest under subparagraph 53(2)(c)(i).

This amendment applies after April 26, 1995.

Subclause 24(5)

ITA
53(2)(c)(i.3)

Subparagraph 53(2)(c)(i.3) of the Act provides for a decrease in the adjusted cost base of a taxpayer's interest in a partnership to the extent of any limited-recourse indebtedness of the taxpayer that can reasonably be considered to have been used to acquire the partnership interest. This paragraph is amended to exclude from its application partnership interests that are tax shelter investments, consequential on the introduction of new section 143.2 of the Act. New section 143.2 provides for the reduction of the amount of certain expenditures of a taxpayer to the extent that a "limited-recourse amount" can reasonably be considered to relate to the expenditure (e.g., in respect of a taxpayer's tax shelter investment). For further details, reference may be made to the commentary on new section 143.2.

Generally, this amendment applies to indebtedness of a taxpayer arising after September 26, 1994.

Subclause 24(6)

ITA
53(4)

Subsection 53(4) of the Act provides rules that affect the computation of the adjusted cost base to a taxpayer of any "specified property" (as defined in section 54). The rules in subsection 53(4) apply where the proceeds of disposition of a specified property are determined under any one of a number of provisions in the Act set out in the subsection. Where this is the case and the adjusted cost base of the specified property was reduced under paragraph 53(2)(g.1) as a consequence of a forgiveness of debt, subsection 53(4) generally provides for the adjusted cost base to continue to be reduced under that paragraph. The only significance of this subsection is with respect to the potential future application of section 80.03 which, in certain cases, recaptures reductions previously taken under paragraph 53(2)(g.1) in computing the adjusted cost base of specified property on a future disposition of such property.

Subsection 53(4) is amended to eliminate the reference in the subsection to paragraph 85.1(1)(a), which covers share-for-share exchanges. This means that reductions made under paragraph 53(2)(g.1) in computing the adjusted cost base to a transferor of shares exchanged under paragraph 85.1(1)(a) will no longer be of any relevance. The change recognizes that section 85.1 involves arm’s length transactions and that a transferee may not be able to obtain information with respect to adjustments under paragraph 53(2)(g.1).

This amendment applies to taxation years that end after February 21, 1994.

Subclause 24(7)

ITA
53(5)

Subsection 53(5) of the Act applies where specified property is disposed of by a person or a partnership (referred to below as the "vendor") to another person or partnership (referred to below as the "transferee") with whom the vendor does not deal at arm’s length, or

with whom the vendor would not deal at arm's length if the assumptions set out in paragraph 80(2)(j) were made. Where this is the case, and subsection 53(4) does not apply to the disposition, there is deducted under subsection 53(5) in computing the adjusted cost base to the transferee, the amount, if any, by which

- the total amounts previously deducted under paragraph 53(2)(g.1) in computing the adjusted cost base to the vendor of that property

exceeds

- the capital gain from the disposition of that property, determined without reference to subsection 100(2) and any reserves claimed by the vendor.

Any amount deducted under subsection 53(5) in computing the adjusted cost base of a property is also added at the same time under this subsection in computing that adjusted cost base.

Subsection 53(5) is amended to provide that, for the purpose of that subsection, a right referred in paragraph 251(5)(b) that is a right of the transferee to acquire the specified property from the vendor or a right of the transferee to acquire other property as part of a transaction or event or series of transactions and events that includes the disposition of the specified property will not create a non-arm's length relationship between the vendor and the transferee.

This amendment applies to taxation years that end after February 21, 1994.

Clause 25

Capital Gains and Losses - Definitions

ITA
54

"superficial loss"

Section 54 of the Act contains various definitions that apply for the purposes of subdivision C – Taxable Capital Gains and Allowable Capital Losses. One of the definitions found in section 54 is that of "superficial loss". Pursuant to paragraph 40(2)(g), a taxpayer's loss from the disposition of property, to the extent that it is a superficial loss, is considered to be nil.

The amendments to this definition delete the description, within the definition itself, of the group of persons and partnerships whose connection with a taxpayer would render any loss on the transfer of property by the taxpayer to a member of that group a superficial loss. As amended, the definition will apply where the taxpayer is "affiliated" with the transferee – using the tests set out in new section 251.1 of the Act. (See the commentary to section 251.1 for further information.)

The amendments also add the following to the list of exclusions from the superficial loss definition:

- a disposition by a corporation whose control is acquired within the following 30 days;
- a disposition by a person who becomes or ceases to be exempt from tax under Part I of the Act within the following 30 days; and
- any disposition to which new subsection 40(3.4) of the Act applies (see the commentary on that subsection for further details).

The acquisition of a right to acquire property may give rise to a superficial loss. The amendments to the definition provide that a right to acquire a property (other than a right that is security for a debt or

similar obligation) is treated for this purpose as a property that is identical to the property.

Finally, the reference to subsection 85(4) of the Act is removed from the definition to reflect the fact that the subsection is being repealed.

These amendments apply to dispositions of property that take place after April 26, 1995, subject to certain exemptions. These are found in clause 156, and generally exclude transactions in progress before April 27, 1995. Readers may refer to the notes to clause 156 for more detail.

Clause 26

Avoidance

ITA
55

Section 55 of the Act deals with certain tax avoidance transactions.

Subclause 26(1)

ITA
55(1)

"permitted redemption"

Subsection 55(1) of the Act contains definitions that are relevant for the purpose of section 55. The definition "permitted redemption" is relevant in determining whether paragraph 55(3)(b) will apply to protect a dividend received in the course of a divisive corporate reorganization from the application of subsection 55(2).

Paragraph (a) of the definition "permitted redemption" is amended, effective for dividends received after February 21, 1994, to include the dividend resulting from a redemption or purchase for cancellation by the distributing corporation of all shares of its capital stock owned, immediately before the distribution, by a transferee corporation in relation to the distributing corporation.

Paragraph (b) of the definition "permitted redemption" is amended, effective for dividends received after February 21, 1994, to include not only the dividend resulting from a redemption or purchase for cancellation of shares of the capital stock of a transferee corporation held by a distributing corporation, but also the dividend resulting from a redemption or purchase for cancellation of shares of the capital stock of a corporation that immediately after the redemption or purchase is a wholly owned subsidiary of the transferee corporation. This change is intended to allow for the indirect distribution of property to a transferee corporation via a transfer to its subsidiary which, after the transfer and as part of the reorganization, is wound up into the transferee corporation.

Subclause 26(2)

ITA
55(1)

"safe-income determination time"

A new term "safe-income determination time" which is relevant for the purposes of new subsection 55(2) and paragraph 55(5)(a) is added to subsection 55(1) effective for dividends received after ANNOUNCEMENT DATE. The safe-income determination time for a transaction or event or a series of transactions or events means the time that is the earlier of the time that is immediately before the payment of a dividend as part of the transaction, event or series and the time that is immediately after the earliest disposition or increase in interest described in any of new subparagraphs 55(3)(a)(i) to (v) of the Act.

Subclause 26(3)

ITA
55(2)

Subsection 55(2) of the Act is an anti-avoidance provision directed against arrangements designed to use the inter-corporate dividend exemption to unduly reduce a capital gain on a sale of shares. It treats the dividend in these situations either as proceeds from the sale of the shares or as a capital gain and not as a dividend received by the corporation.

Subsection 55(2) does not apply where the gain that has been reduced can be attributed to the share’s portion of the income ("safe income") earned or realized by any corporation after 1971 and before the transaction or event or the commencement of the series of transactions or events that results in a disposition of property, or an increase in corporate interest, referred to in paragraph 55(3)(a). Safe income is protected from the application of subsection 55(2) because this income has been subject to corporate income tax and should therefore be allowed to be paid as a tax-free dividend to other Canadian corporations.

Subsection 55(2) of the Act is amended, applicable to dividends received after ANNOUNCEMENT DATE, to provide a new later cut-off point for the period (currently at the time of the transaction or the commencement of the series) for determining safe-income. The new cut-off point is referred to as the "safe-income determination time" for the transaction or event or the series of transactions or events and is defined in subsection 55(1). Reference may be made to the commentary on subsection 55(1) for further information on the meaning of "safe-income determination time". Subsection 55(2) is also amended to add a reference to subsection 112(2) of the Act.

New subsection 55(2) of the Act provides that safe income of a corporation will be determined as income earned or realized by a corporation after 1971 and before the "safe-income determination time" as defined in subsection 55(1) of the Act. Safe income now includes the income arising up to the earlier of the time that is immediately after the earliest disposition or increase in interest described in any of subparagraphs 55(3)(a)(i) to (v) and the time that is immediately before the earliest time that a dividend is paid as part of the transaction, event or series. New subsection 55(2) applies to dividends received after ANNOUNCEMENT DATE.

Subclauses 26(4) and (5)

ITA
55(3)(a)

Subsection 55(3) of the Act sets out circumstances in which subsection 55(2) of the Act does not apply to dividends. Paragraph 55(3)(a) provides an exemption from the application of subsection 55(2) for dividends received in certain related-party

transactions. In particular, paragraph 55(3)(a) exempts dividends received as part of a series of transactions or events that does not result in a disposition of property to, or a significant increase in interest in any corporation of, any person who is not related to the corporation that received the dividend. Paragraph 55(3)(a) is amended to allow for, amongst other things, certain dispositions of money as well as of property for proceeds equal to the fair market value at the time of disposition. Therefore a deemed dividend arising on a redemption of shares received on a transfer of property under section 85 of the Act to a related corporation for sale outside the related group may now be exempted from the application of subsection 55(2) as may a disposition of money on the payment of dividends.

In particular, subsection 55(2) will not apply to dividends received by a corporation (the "dividend recipient") if as part of a transaction or event or a series of transactions or events in which the dividend was received there was not at any particular time

- a disposition of property to a person or partnership who was an unrelated person immediately before the particular time other than a disposition of

    (1) money for the payment of dividends or the reduction of paid-up capital of shares, and

    (2) property for proceeds that are not less than its fair market value at the time of disposition;

- an increase in the total direct interest in any corporation of one or more persons or partnerships who were unrelated persons immediately before the particular time unless the increase resulted from a disposition of shares of a corporation for proceeds of disposition that are not less than the fair market value of those shares at the time of the increase;

- a disposition to a person or partnership who was an unrelated person immediately before the particular time of shares of the corporation that paid the dividend (the "dividend payer") or property more than 10% of the fair market value of which was at any time during the series derived from the shares of the dividend payer;

- after the time the dividend was received, a disposition to a person or partnership who was an unrelated person immediately before the particular time of shares of the dividend recipient or property more than 10% of the fair market value of which at any time during the series is derived from shares of the dividend recipient; or

- a significant increase in the total of all direct interests in the dividend payer of one or more persons or partnerships who were unrelated persons.

New paragraph 55(3.01)(a) of the Act sets out the meaning of "unrelated person" for the purpose of new paragraph 55(3)(a). An "unrelated person" means a person (other than the dividend recipient) to whom the dividend recipient is not related or a partnership any member of which (other than the dividend recipient) is not related to the dividend recipient.

As well, new subsection 55(3.01) of the Act sets out for the purposes of new paragraph 55(3)(a) the consequences of an amalgamation of corporations or a winding-up of a subsidiary corporation to which subsection 88(1) of the Act applies. New paragraph 55(3.01)(b) provides that the corporation formed on an amalgamation is treated as a continuation of its predecessors. New paragraph 55(3.01)(c) provides that when there is a winding-up of a subsidiary corporation into its parent to which subsection 88(1) of the Act applies, the parent is treated as a continuation of the subsidiary.

New paragraph 55(3.01)(d) of the Act provides that the proceeds of disposition, for the purposes of applying the tests in new paragraph 55(3)(a) of the Act, will be determined without reference to "paragraph 55(2)(a)" in paragraph (j) of the definition of "proceeds of disposition" in section 54.

The following examples illustrate the application of new paragraph 55(3)(a) of the Act:

EXAMPLE 1 ... Arm's Length Asset Sale

> *A corporation (Buyerco) wishes to acquire from an unrelated corporation (Sellco) a particular asset (the target asset). Sellco transfers, on a tax-deferred basis under section 85 of the Act, the*

target asset to Buyerco. In consideration for the transferred asset Buyerco issues to Sellco preferred shares with an adjusted cost base to Sellco equal to the tax cost of the transferred asset immediately before the transfer. The paid-up capital of the preferred shares does not exceed their adjusted cost base to Sellco which is the adjusted cost base of the transferred property and the redemption amount of the preferred shares is equal to the fair market value of the transferred property. Such preferred shares with a high redemption value and low paid-up capital are commonly referred to as "High/Low Shares".

Result: Buyerco and Sellco are not related and the disposition of the target asset was not for proceeds of disposition equal to the fair market value at the time of disposition. The test in subparagraph 55(3)(a)(i) is not met. The dividends arising on the redemption by Buyerco of the High/Low Shares are therefore not eligible for the exemption in paragraph 55(3)(a) of the Act.

EXAMPLE 2 ... In-House Loss Utilization

A corporation (Parentco) has two wholly-owned subsidiary corporations (Profitco) and (Lossco). Profitco owns, amongst other things, all the shares of a subsidiary corporation (Target) which it wishes to sell to an unrelated person. The fair market value of the shares of Target exceeds their adjusted cost base to Profitco and therefore Parentco wants the gain which will arise on the disposition of those shares to be realized in Lossco rather than Profitco. Profitco transfers, on a tax-deferred basis under section 85 of the Act, the Target shares to Lossco in consideration for High/Low Shares of Lossco. Lossco then sells the shares of Target to the unrelated person for proceeds of disposition equal to the fair market value of the shares. The High/Low shares of Lossco are then redeemed.

Result: All five of the tests in new paragraph 55(3)(a) of the Act are met and therefore the dividends arising on the redemption by Lossco of the High/Low shares are not subject to subsection 55(2).

EXAMPLE 3 ... A Redemption of a Minority Shareholder Interest

A corporation (ACo) and an unrelated corporation (BCo) own 60% and 40% respectively of a third corporation (XCo). XCo redeems its shares held by BCo.

Result: Any dividends arising on the redemption by XCo of its shares held by BCo are not eligible for the exemption in paragraph 55(3)(a) of the Act.

- *The redemption of the XCo shares held by BCo is a disposition of property to an unrelated person for proceeds of disposition less than fair market value at the time of disposition. The test in new subparagraph 55(3)(a)(i) of the Act is not met;*

- *There is a significant increase in ACo's (unrelated person's) total direct interest in XCo (the dividend payer) as a result of a disposition (redemption) of the shares of XCo for proceeds of disposition less than fair market value. The test in new subparagraph 55(3)(a)(ii) is not met;*

- *There is a disposition of the shares of XCo to XCo which is a person unrelated to BCo (the dividend recipient). The test in new subparagraph 55(3)(a)(iii) is not met; and*

- *There is a significant increase in the total direct interest in XCo by ACo, a person unrelated to BCo. The test in new subparagraph 55(3)(a)(v) is not met.*

EXAMPLE 4 ... A Redemption of a Majority Shareholder Interest

A corporation (ACo) and an unrelated corporation (BCo) own 40% and 60% respectively of the shares of a third corporation (XCo). XCo redeems its shares held by BCo.

Result: Any dividends arising on the redemption by XCo of its shares held by BCo are not eligible for the exemption in paragraph 55(3)(a) of the Act.

- *There is a significant increase in ACo's (an unrelated person's) direct interest in XCo (the dividend payer) as a result of a disposition of the shares of XCo for proceeds of*

disposition less than fair market value. The test in new subparagraph 55(3)(a)(ii) is not met; and

- *There is a significant increase in the total direct interest in XCo by ACo which is a person unrelated to BCo. The test in new subparagraph 55(3)(a)(v) is not met.*

EXAMPLE 5 ... A Corporate Reorganization and Arm's Length Asset Sale

A corporation (BuyerCo) owns all the shares of another corporation (SubCo). Buyerco acquires all the shares of a third corporation (Target) for fair market value. Target owns all the shares of two corporations - T1Subco and T2Subco. Target transfers, on a tax-deferred basis under section 85 of the Act, all the shares of T2Subco to SubCo in consideration for High/Low Shares of SubCo. SubCo subsequently redeems the High/Low Shares. Target sells the shares of T1Subco to a third party for proceeds of disposition equal to fair market value at the time of the disposition.

Result: The dividends arising on the redemption by SubCo of its shares held by Target are not subject to subsection 55(2) of the Act. The tests in new paragraph 55(3)(a) are met.

EXAMPLE 6 ... A Transfer of Assets Within a Group of Related Corporations

The shares of a corporation (ACo) are owned 49% by XCo and 51% by MCo. ACo owns all the shares of SubCo. The shares of another corporation BCo are owned 49% by YCo and 51% by MCo. ACo transfers, on a tax-deferred basis under section 85 of the Act, all the shares of SubCo to BCo in consideration for High/Low Shares of BCo. BCo redeems its shares held by ACo.

Result: The dividends arising on the redemption by BCo of its shares held by ACo are not subject to subsection 55(2) of the Act. This was not a disposition of property to an unrelated party; therefore, the test in new subparagraph 55(3)(a)(i) is met. YCo has increased its indirect interest in SubCo but not its direct interest in SubCo; therefore the test in new

subparagraph 55(3)(a)(ii) of the Act is met. The tests in new subparagraphs 55(3)(a)(iii),(iv) and (v) are also met.

EXAMPLE 7 ... Internal Corporate Reorganization

MCo is a public corporation that is widely held. MCo owns all the shares of two other corporations YCo and XCo. On July 15, 1996, MCo incorporates Topco and transfers, on a tax-deferred basis under section 85 of the Act, all the shares of XCo to Topco in consideration for High/Low Shares of Topco. Each share of MCo held by the public is exchanged for a corresponding share of Topco. Topco is now the parent of MCo. Topco redeems the High/Low Shares.

Result: The dividends arising on the redemption by Topco of its shares held by MCo are subject to subsection 55(2) of the Act. There is a significant increase in the total direct interest of the former shareholders of MCo in Topco, the dividend payer. The tests in new subparagraphs 55(3)(a)(ii) and (v) are not met.

Subject to specified grandfathering set out in (i) and (ii) below, new paragraph 55(3)(a) and new subsection 55(3.01) of the Act apply to dividends received by a corporation after February 21, 1994. Grandfathering is provided for dividends received in the following circumstances:

(i) dividends received before ANNOUNCEMENT DATE, or under an arrangement substantially advanced, as evidenced in writing, before ANNOUNCEMENT DATE, provided item (ii) below does not apply;

and

(ii) dividends received on shares issued before ANNOUNCEMENT DATE, provided the corporation elects in writing before the end of the fourth month after the month in which new paragraph 55(3)(a) and new subsection 55(3.01) of the Act become law or in its tax return for the year in which the dividend was received.

Where the circumstances in item (i) exist, new subparagraphs 55(3)(a)(ii) and (v) will be read as:

> "(ii) a significant increase (other than as a consequence of a disposition of shares of the capital stock of a corporation for proceeds of disposition that are not less than their fair market value) in the interest in any corporation of one or more persons who were unrelated persons immediately before the particular time,"

and

> "(v) a significant increase in the interest in the dividend payer of one or more persons who were unrelated persons immediately before the particular time; or"

Where the circumstances in item (ii) exist, the Act will be read without reference to new subsection 55(3.01) and paragraph 55(3)(a) will be read as:

> "(a) unless the dividend was received as part of a transaction or event or series of transactions or events that resulted in
>
> > (i) a disposition of any property to a person with whom the dividend recipient was dealing at arm's length, or
> >
> > (ii) a significant increase in the interest in any corporation of any person with whom the dividend recipient was dealing at arm's length; or"

As well, where the circumstances in item (ii) exist, subsection 55(4) and paragraph 55(5)(e) of the Act will be read as follows:

1. Subsection 55(4) of the Act will be read as it read for dividends before February 22, 1994, and

2. Paragraph 55(5)(e) of the Act will provide that in determining whether two or more persons deal with each other at arm's length

- a brother and a sister will be treated as dealing with each other at arm's length and not related to each other, and

- persons who are otherwise related to each other solely because of a right referred to in paragraph 251(5)(b) will be treated as not related to each other.

Subclause 26(6)

ITA
55(3.1)(c)

A dividend received by a corporation to which subsection 55(2) of the Act would, but for the butterfly reorganization exemption in paragraph 55(3)(b), apply will be denied the protection of paragraph 55(3)(b) under subsection 55(3.1) where the conditions set out in any of paragraphs 55(3.1)(a) to (d) exist.

Paragraph 55(3.1)(c) denies the protection of paragraph 55(3)(b) for a dividend received by a transferee corporation where, as part of the series of transactions or events that include the receipt of the dividend, certain described property with a fair market value greater than 10% of the fair market value, at the time of distribution, of the property received by the transferee corporation on the distribution of property as part of the butterfly reorganization, becomes property of a partnership or of a person who is not related to the transferee. The described property is composed of the following three types:

1. property received by the transferee on the distribution;

2. property more than 10% of the fair market value of which is attributable to distributed property; and

3. property to which more than 10% of the fair market value of the distributed property can be attributed.

Clause 55(3.1)(c)(ii)(B) is amended to clarify that the 10% fair market value test for the second type of property is to be determined by reference to distributed property other than money and indebtedness that is not convertible into other property. The amendment also ensures that the second type of property includes property the value of which is attributable to property described in the third type. New clause 55(3.1)(c)(ii)(B) of the Act applies to dividends received after April 26, 1995 except that the clause will be read without reference to clause (C) for acquisitions of property before ANNOUNCEMENT DATE or at any time pursuant to a written agreement made before ANNOUNCEMENT DATE.

Clause 55(3.1)(c)(ii)(C) is amended applicable to dividends received after April 26, 1995 to alter the description of the third type of property. The third type of property will be composed of property to which the fair market value of the distributed property can be wholly or partly attributed.

Subclause 26(7)

ITA
55(3.1)(d)

A dividend received by a corporation to which subsection 55(2) would, but for the butterfly reorganization exemption in paragraph 55(3)(b), apply will be denied the protection of paragraph 55(3)(b) under subsection 55(3.1) where the conditions set out in any of paragraphs 55(3.1)(a) to (d) exist.

Paragraph 55(3.1)(d) denies the protection of paragraph 55(3)(b) for a dividend received by the distributing corporation where, as part of the series of transactions or events that include the receipt of the dividend, certain described property with a fair market value greater than 10% of the fair market value, at the time of distribution, of the property owned by it immediately before the distribution and not disposed of by it on the distribution, is acquired by a partnership or a person who is not related to the distributing corporation.

The described property is composed of the following three types:

1. property retained by the distributing corporation immediately after the distribution;

2. property more than 10% of the fair market value of which is attributable to property retained by the distributing corporation; and

3. property to which more than 10% of the fair market value of the property retained can be attributed.

Clause 55(3.1)(d)(ii)(B) of the Act is amended to clarify that the 10% fair market value test for the second type of property is to be determined by reference to retained property other than money and indebtedness that is not convertible into other property. The

amendment also ensures that the second type of property includes property the value of which is attributable to property described in the third type. Clause 55(3.1)(d)(ii)(B) is also amended to ensure that the wording is consistent with the wording in clause 55(3.1)(c)(ii)(B). New clause 55(3.1)(d)(ii)(B) of the Act applies to dividends received after April 26, 1995 except that the clause will be read without reference to clause (C) for acquisitions of property before ANNOUNCEMENT DATE or at any time pursuant to a written agreement made before ANNOUNCEMENT DATE.

Clause 55(3.1)(d)(ii)(C) is amended applicable to dividends received after April 26, 1995 to make the wording consistent with the wording in clause 55(3.1)(c)(ii)(C).

Subclause 26(8)

ITA
55(3.2)

Subsection 55(3.2) of the Act sets out a number of interpretative rules for the purpose of paragraph 55(3.1)(b). New paragraph 55(3.2)(h) of the Act provides that each corporation that is a shareholder and specified shareholder of a distributing corporation at any time during the course of a series of transactions or events, a part of which includes a distribution, will be treated as a transferee corporation in relation to the distributing corporation. New paragraph 55(3.2)(h) of the Act applies to dividends received after ANNOUNCEMENT DATE other than dividends received in the course of a reorganization that was required on ANNOUNCEMENT DATE to be carried out pursuant to a written agreement made before ANNOUNCEMENT DATE. For this purpose, a reorganization is considered not to be required to be carried out where the parties to the agreement can be relieved of the requirement if there is a change to the Act.

EXAMPLE

> *The shares of a Canadian corporation (ZCo.) are owned 50% by XCo. and 50% by YCo. XCo. is owned 50% by ACo. and 50% by BCo. A third corporation, PCo. acquires the shares of XCo. from ACo. and BCo. During the course of a butterfly reorganization, ZCo. distributes 50% of its property to YCo. After the reorganization, XCo owns all the shares of ZCo., the distributing corporation.*

This reorganization does not qualify for the butterfly exemption in paragraph 55(3)(b) of the Act because of the application of subparagraph 55(3.1)(b)(ii) and new paragraph 55(3.2)(h). Under new paragraph 55(3.2)(h) of the Act, XCo. is a transferee corporation in relation to the distributing corporation, ZCo. Control of XCo. was acquired by PCo. during the course of the series of transactions which included the distribution of ZCo.'s property to YCo.

Subclause 26(9)

ITA
55(5)(a)

Subsection 55(5) of the Act sets out application provisions for the purposes of section 55 of the Act. Paragraph 55(5)(a) of the Act provides that the portion of the capital gain that is attributable to income expected to be earned or realized by a corporation after the receipt of a dividend referred to in subsection 55(2), shall be deemed to be a portion of a capital gain attributable to anything other than income. Paragraph 55(5)(a) of the Act is amended for dividends received after ANNOUNCEMENT DATE as a consequence of the changes to subsection 55(2) of the Act and the introduction of the new term "safe-income determination time" in subsection 55(1) of the Act. Amended paragraph 55(5)(a) provides that the portion of the capital gain that is attributable to income expected to be earned or realized by a corporation after the safe-income determination time will be considered to be a portion of a capital gain attributable to anything other than income.

Subclause 26(10)

ITA
55(5)(c)

Paragraph 55(5)(c) of the Act provides that the income earned or realized by a corporation for the period in which it was a private corporation is its income otherwise determined for the period without deducting amounts under section 37.1 or paragraph 20(1)(gg) of the *Income Tax Act*, chapter 148 of the Revised Statutes of Canada, 1952. Paragraph 55(5)(c) is amended, effective for the 1995 and subsequent

taxation years as a consequence of the repeal of section 37.1 of the Act.

Clause 27

Amounts Included in Income

ITA
56(1)

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.

New paragraph 56(1)(r) requires that certain amounts received as social assistance under projects sponsored by the federal government under which benefits are paid to supplement individuals' income from employment be included in computing the recipient's income.

Paragraph 56(1)(u) of the Act is also amended to clarify that it does not apply to employment earnings supplements included in income under new paragraph 56(1)(r).

These amendments apply to the 1993 and subsequent taxation years.

Clause 28

Deduction for Insolvency

ITA
61.3(1) and (2)

Subsections 61.3(1) and (2) of the Act provide deductions for corporations with respect to amounts included in income under subsection 80(13) because of the application of the debt forgiveness rules.

Subsections 61.3(1) and (2) are amended to eliminate the reference in the subsections to subsection 80(17), strictly as a consequence of the repeal of that subsection.

These amendments apply to taxation years that end after February 21, 1994.

Clause 29

Moving Expenses

ITA
62(3)(f)

Section 62 of the Act provides a deduction for the qualifying moving expenses of an individual who moves to a new residence in Canada in order to take up employment or start a business. Subsection 62(3) defines moving expenses to include, among other items, taxes imposed on the transfer or registration of title to a new residence where an individual sells an old residence as a result of the move.

This amendment to paragraph 62(3)(f) of the Act, which applies to moving expenses incurred after 1990, clarifies that the deduction in respect of taxes on the purchase of a new residence does not include any goods and services tax related to the purchase of that residence.

Clause 30

Child Care Expenses

ITA
63(3)

Section 63 of the Act provides rules concerning the deductibility of child care expenses in computing an individual's income. Subsection 63(3) contains the definition "earned income". In any year, an individual is not allowed to deduct child care expenses that exceed two-thirds of earned income for that year.

This amendment to the definition "earned income" adds to that income base amounts included in income under new paragraph 56(1)(r) of the Act. These amounts represent certain employment earnings supplements received under federal government projects.

This amendment applies to 1993 and subsequent taxation years.

Clause 31

Exploration and Development Expenses

ITA
66

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

Subclauses 31(1) and (2)

ITA
66(4)(b)

Subsection 66(4) of the Act sets out the deduction that may be claimed for foreign exploration expenses. The deduction that may be claimed for a taxation year is a minimum of 10% of the undeducted balance of such expenses at the end of the year, but a higher amount (up to the undeducted balance) may be claimed to the extent of the taxpayer's specified foreign-source resource income. For this purpose, the closing words of paragraph 66(4)(b) provide that the foreign resource income is determined without reference to deductions under subsections 66(1), (3) and (4), section 65 and subsections 66.1(2) and (3).

This amendment, which applies to taxation years that end after May 6, 1974, moves the closing words of paragraph 66(4)(b) to become the closing words of subparagraph 66(4)(b)(ii). This clarifies that the rule contained in these closing words applies only for the purpose of computing a taxpayer's specified foreign-source resource income.

Subclause 31(3)

ITA
66(11.4)

Subsection 66(11.4) of the Act applies where there is an acquisition of control of a corporation that was not a principal-business corporation immediately before the 12-month period preceding that acquisition of control. Under this rule, any Canadian or foreign resource property acquired by the corporation in that period is considered to have been acquired at the time control is acquired for the purpose of calculating the corporation's foreign exploration and development expenses, cumulative Canadian development expense and cumulative Canadian oil and gas property expense.

Paragraph 66(11.4)(b) is amended as a consequence of the introduction of the concept of "affiliated persons" in new section 251.1 of the Act. (See the commentary to new section 251.1 for further information.) Subsection 66(11.4) formerly contained an exception from its application where the property in question was owned before the 12-month period described above by the corporation whose control was acquired, by a partnership of which the corporation was a majority interest partner, or by a person or persons related to the corporation. As amended, this exception will apply where the property was owned by a person that was affiliated with the corporation, within the meaning that would be assigned by new section 251.1 if that section were read without reference to the extended definition of "controlled" in subsection 251.1(2).

Amended subsection 66(11.4) applies after April 26, 1995.

Subclause 31(4)

ITA
66(12.66)

Subsections 66(12.6) and (12.601) of the Act permit a principal-business corporation to renounce Canadian exploration expenses (CEE) and Canadian development expenses (CDE) to a flow-though shareholder. A corporation may only renounce CEE or CDE incurred by it on or before the effective date of the renunciation. For the purposes of these subsections, where a number

of stated conditions are met, subsection 66(12.66) treats CEE and CDE incurred in the first 60 days of a calendar year as having been incurred at the end of the preceding calendar year.

Subsection 66(12.66) is amended so that this "lookback" rule also applies for the purposes of paragraph 66(12.602)(b). Under this paragraph, a corporation may only renounce CDE under subsection 66(12.601) to the extent of the corporation’s cumulative CDE on the effective date of the renunciation. The amendment ensures that, where the effective date of the renunciation by a corporation is the last day of a calendar year, CDE incurred in the first 60 days of the following calendar year is taken into account for the purposes of computing cumulative CDE under paragraph 66(12.602)(b).

This amendment applies to expenses incurred after 1992.

Subclause 31(5)

ITA
66(12.75)(c)

Subsection 66(12.75) of the Act sets out penalties for the late filing of specified documents and for the late renunciations of resource expenses in connection with flow-through share financings.

In order for a late renunciation to have any effect, the renouncing corporation is required under subsection 66(12.741) to pay a penalty in respect of the renunciation. A cross reference in paragraph 66(12.75)(c) is amended to ensure that this paragraph applies for the purposes of determining this penalty. The penalty in respect of a late renunciation is equal to the lesser of $15,000 and the greater of $100 and .25% of the amount renounced.

This amendment applies to renunciations purported to be made after February 1993.

Subclause 31(6)

ITA
66(15)

"Canadian exploration and development expenses"

Subsection 66(15) of the Act defines "Canadian exploration and development expenses". Under paragraph (c) of the definition, such expenses include a cost incurred before May 7, 1974 for a "Canadian resource property".

The definition is amended to clarify that the cost of Canadian resource property acquired before 1972 is not included as a Canadian exploration and development expense. This amendment, which applies to taxation years that begin after 1984, is consequential on a broadening of the definition "Canadian resource property" in 1985 to include specified property acquired before 1972.

Clause 32

Successor Rules - Acquisition from Tax-Exempt

ITA
66.6

Subsections 66.6(1) and (2) of the Act provide special exceptions to the resource property successor rules in subsection 29(25) of the *Income Tax Application Rules* (ITAR) and section 66.7 of the Act. The exceptions apply where a corporation has, after July 19, 1985, acquired all or substantially all of the Canadian resource properties of a tax-exempt person. This amendment simplifies and consolidates both subsections. Under amended section 66.6, a corporation that acquires all or substantially all of a tax-exempt's Canadian resources will not be subject to ITAR subsection 29(25) or subsections 66.7(1) to (5) of the Act in respect of that acquisition. The amendment applies to acquisitions that take place after April 26, 1995 other than acquisitions occurring before 1996 that were required by a written agreement made before April 27, 1995.

Clause 33

Exploration and Development Expenses - Successor Rules

ITA
66.7

Section 66.7 of the Act includes what are commonly known as the "successor rules" with respect to resource properties and expenditures. Under subsection 66.7(10), certain of these rules apply in modified form to a corporation that has undergone an acquisition of control or has ceased to be exempt from tax under Part I of the Act on its taxable income.

Subclauses 33(1) to (5)

ITA
66.7(1) to (5)

Subsections 66.7(1) to (5) of the Act allow a corporation to claim deductions with respect to Canadian exploration and development expenses, foreign exploration and development expenses, Canadian exploration expenses, Canadian development expenses and Canadian oil and gas property expenses incurred by one or more other taxpayers, where property has been acquired by the corporation in circumstances to which the successor rules apply.

Paragraphs 66.7(1)(b), (2)(b), (3)(b), (4)(b) and (5)(b) are amended to eliminate the reference in the paragraphs to subsection 80(17), strictly as a consequence of the repeal of that subsection.

These amendments apply to taxation years that end after February 21, 1994.

Subclause 33(6)

ITA
66.7(10)(b)

Paragraph 66.7(10)(b) of the Act is amended so that it will not apply to corporations that cease to be taxable after April 26, 1995. This change forms part of a set of amendments to the tax treatment of

corporations that become or cease to be taxable. More details are provided in the notes to amended subsection 149(10).

Subclause 33(7)

ITA
66.7(10)(c.1)

New paragraph 66.7(10)(c.1) of the Act applies where a corporation no longer owns any foreign resource property at the time of the acquisition of its control or its change in tax-exempt status. In these circumstances, the corporation is deemed to own a foreign resource property immediately before the acquisition of control or change in tax-exempt status. As a consequence, because of paragraph 66.7(10)(c) and subsection 66.7(2), "streamed income" from Canadian resource properties owned immediately before the acquisition of control or change in tax-exempt status can be used so that up to 10% of the undeducted balance of foreign exploration expenses can be claimed by the corporation under subsection 66.7(2).

This amendment applies to taxation years that end after February 17, 1987.

Clause 34

Inadequate Consideration

ITA
69

Section 69 of the Act provides a series of rules dealing primarily with transactions entered into between non-arm’s length persons or on non-arm’s length terms.

Subclauses 34(1) and (2)

ITA
69(5)

Subsection 69(5) sets out rules to ensure that, where property is appropriated by a shareholder on the winding-up of a corporation, the property is to be treated as having been transferred at its fair market value with the consequent recognition of any resulting income or loss on the transfer. The amendment to paragraph 69(5)(a), which applies to windings-up that begin after 1995, deletes the reference to paragraph 40(2)(e) and is strictly consequential on the repeal of that provision. The amendment replacing paragraphs 69(5)(d) and (e) with a new paragraph (d), which applies subject to a transitional provision to windings-up that begin after April 26, 1995, deletes the references to paragraph 40(2)(e) and to subsections 85(4) and (5.1), which are also being repealed. It also adds references to new subsections 13(21.2), 14(12), 18(13), 40(3.4) and 40(3.6) to ensure that those provisions do not apply with respect to windings-up dealt with under subsection 69(5).

Subclauses 34(3) and (4)

ITA
69(11) to (13)

Subsection 69(11) of the Act is an anti-avoidance rule that is intended to prevent a vendor from disposing of property on a tax-deferred basis as part of a series of transactions one of the main purposes of which is to obtain the benefit of tax deductions or other entitlements available to a specified person (as defined in subsection 69(12)) in respect of a subsequent disposition of the property within 3 years of the original disposition. Where it applies, subsection 69(11) denies the benefit of the rollover on the original disposition by deeming the vendor's proceeds of disposition to be equal to the fair market value of the property disposed of.

Subsection 69(11) is amended to deny the rollover on the original disposition where one of the main purposes of the series of transactions is to use the tax-exempt status of any person to shelter from tax under Part I of the Act any income arising on a subsequent disposition of the property. Subsection 69(11) is also amended by

removing the 3-year limitation for the subsequent disposition of the property and replacing it with a provision which permits the subsection to apply only if arrangements for the subsequent disposition have been made within the 3-year period.

Subsection 69(11) is also amended to delete the reference to specified person and to use instead the concept of affiliated person introduced in new section 251.1 of the Act. (See the commentary to new section 251.1 for further information.) As amended, subsection 69(11) will not apply where, on a transfer of property, any tax deductions or entitlements that may apply on a subsequent disposition of the property are those available to a person that would be affiliated with the vendor of the property if the affiliation test set out in new section 251.1 were read without reference to the extended definition of "controlled" in subsection 251.1(2) of the Act.

As a consequence of this last amendment to subsection 69(11), subsection 69(12) – which defined the term "specified person" – is being repealed and subsection 69(13) renumbered to take the place of subsection 69(12). New subsection 69(12) allows the Minister of National Revenue to assess or reassess at any time the tax, interest and penalties, if any, payable as a consequence of the application of subsection 69(11) where arrangements to sell the property have been made within 3 years of the original disposition.

Subject to a special grandfathering provision, these amendments apply to a disposition that is part of a series of transactions that begins after April 26, 1995.

Clause 35

Death of a Taxpayer

ITA
70

Section 70 of the Act provides certain rules that apply on the death of an individual.

Subclause 35(1)

ITA
70(3)

Subsection 70(3) of the Act deals with "rights or things" transferred to certain beneficiaries of a deceased individual within a specified time.

An amendment was made to paragraph 70(3)(b) in the Fifth Supplement of the Revised Statutes of Canada, 1985 to make the paragraph gender neutral. The pronouns "his" and "he", which originally referred to a beneficiary or other such persons, were erroneously replaced with the word "taxpayer" in the English version of the Act. This amendment replaces the word "taxpayer" with the correct term: "beneficiary or person".

This amendment applies to taxation years that end
after November 1991, as these are the taxation years to which the amendment made in the Fifth Supplement of the Revised Statutes of Canada, 1985 applies.

Subclause 35(2)

ITA
70(10)

"share of the capital stock of a family farm corporation"

Subsection 70(10) of the Act contains definitions that are relevant for the purposes of the spousal and intergenerational rollover provisions in sections 70 and 73 of the Act. The existing definition "share of the capital stock of a family farm corporation" requires that the corporation's farm property be used by certain persons principally in the course of carrying on the business of farming in Canada in which the owner of the share or a parent, spouse or child of the owner is actively engaged in regular and continuous basis. Those persons include, among others, the owner of the share, the corporation and any other corporation a share of the capital stock of which was a share of the capital stock of a family farm corporation of that owner. Subparagraph (a)(i) of the definition is amended, effective
for the 1994 and subsequent taxation years, to allow the property to

be used by any other corporation related to the corporation in the qualifying farming business. This allows the property used in the qualifying farming business of one corporation to be held not only by that corporation or a sister corporation but also by a subsidiary or parent corporation of that corporation.

Clause 36

Debt Forgiveness

ITA
80

Section 80 sets out the existing rules that apply where an obligation of a debtor to pay an amount is settled or extinguished for less than its principal amount and the amount for which it was issued.

Subclause 36(1)

ITA
80(1)

"unrecognized loss"

The amount of a debtor's "unrecognized loss", as defined in subsection 80(1) of the Act, can be used to offset the amount otherwise included under subsection 80(13) in computing the debtor's income. Subject to exceptions where there has been an acquisition of control, a debtor's "unrecognized loss" is equal to total capital losses from the disposition of property that are denied under subparagraph 40(2)(g)(ii).

The definition "unrecognized loss" in subsection 80(1) is amended to clarify that a debtor's "unrecognized loss" is determined with reference to dispositions by the debtor of property.

This amendment applies to taxation years that end after February 21, 1994.

Subclause 36(2)

ITA
80(2)(g) and (g.1)

Subsection 80(2) of the Act provides a number of rules that apply for the purpose of the debt forgiveness rules in section 80. Paragraph 80(2)(g) provides that the amount paid in satisfaction of a debt issued by a corporation and payable to a person is, where any part of the consideration for the settlement of the debt is a share issued by the corporation (other than an excluded security), considered to equal the fair market value of the share plus any increase in the fair market value of other shares owned by the person that results from the settlement of the debt. A corporate debtor is also considered to have paid an amount in satisfaction of a debt where the debtor does not issue any share, to the extent that an increase in the fair market value of shares of the capital stock of the debtor that are owned by the creditor results from the settlement of the debt.

Subsection 80(2) is amended, applicable to taxation years that end after February 21, 1994, so that existing paragraph 80(2)(g) is split into two rules. Under amended paragraph 80(2)(g), a corporate debtor is considered to have paid an amount in satisfaction of a debt equal to the fair market value of a share, where that share is issued by the debtor as consideration for the settlement of the debt. Under new paragraph 80(2)(g.1), a corporate debtor is considered to have paid an amount equal to the increase in value of shares of the capital stock of the debtor that are owned by the creditor (other than those shares issued as consideration for the settlement of the debt) to the extent that the increase in value is as a consequence of the settlement of the debt. The main difference between existing paragraph 80(2)(g) and new paragraphs 80(2)(g) and (g.1) is that the new paragraphs do not limit the amount that is considered to have been paid in satisfaction of a debt because of any non-share consideration that is given by a debtor.

Subclause 36(3)

ITA
80(13)B(b)

Where a commercial obligation issued by a debtor is settled, 75% (or, where the debtor is a partnership, 100%) of the debtor's unapplied forgiven amount after the application of subsections 80(3) to (12) of the Act is added in computing the debtor's income. However, the net amount included in computing the debtor's income under subsection 80(13) is subject to a number of adjustments specified in subsection 80(13).

One of these adjustments in respect of a settlement is the addition of the amount determined for B in subsection 80(13). B is currently defined as the lesser of two amounts. The first amount is the total designated under subsection 80(11) in respect of the settlement. The second amount is the total of:

- the "residual balance" (as determined under subsection 80(14)) in respect of the settlement, and

- the amount, if any, by which the amount determined for C (i.e., specified amounts transferred to a related person under section 80.04) exceeds the amount determined for A (i.e. unapplied forgiven amount after the application of subsections 80(3) to (12)).

As a consequence of the amended definition of "residual balance" in amended subsection 80(14), a transfer under new section 80.04 in respect of a settlement of debt will no longer give rise to a lower residual balance as of the time of settlement. Accordingly, the second amount referred to above in respect of a settlement is now simply described as equal to the residual balance as of the time of the settlement.

This amendment applies to taxation years that end after February 21, 1994.

Subclause 36(4)

ITA
80(14) and (14.1)

Subsection 80(14) of the Act defines the expression "residual balance". In general terms, a debtor's "residual balance" is equal to the total of income tax attributes (other than those described in subsection 80(11)) of certain corporations and partnerships related to the debtor (which are referred to as "directed persons") remaining after the settlement of a commercial obligation issued by the debtor, taking into account the application of section 80.04 in respect of that settlement. The expression "directed person" is defined in subsection 80(1).

Subsection 80(14) is amended, in conjunction with the introduction of subsection 80(14.1), to provide a simpler manner of determining a debtor's "residual balance", which produces essentially the same results. In cases where only one commercial obligation issued by a debtor is settled in a taxation year, a debtor's "residual balance" is now equal to the total income tax attributes (other than those described in subsection 80(11)) of the debtor's directed persons remaining before taking into account the application of section 80.04 in respect of a settlement of a commercial obligation issued by the debtor MINUS the portion of the forgiven amount in respect of the obligation that represents the amount determined for A in subsection 80(13) in respect of the settlement. The total income tax attributes referred to above are now defined as "gross tax attributes" in new subsection 80(14.1), as described in greater detail below. A further simplification in describing the "residual balance" is achieved by referring in all relevant cases to the amounts determined for A, B and C in subsection 80(13) rather than any resulting income inclusions, which avoids the need for adjustments to take into account the 75% inclusion rate under subsection 80(13) for debtors (other than partnerships).

Under new subsection 80(14.1), the "gross tax attributes" of directed persons is equal to the maximum total forgiven amount that could be applied under subsections 80(3) to (10) and (12) in respect of the settlement of notional commercial obligations that are deemed to have been issued by each of those directed persons. "Gross tax attributes" are calculated at any time in a debtor's taxation year on the

assumption that the notional obligations referred to above had been settled at that time and that the forgiven amount in respect of each of those settlements is equal to the total forgiven amounts determined at and before the time and in the year. Apart from the fact that tax attributes of directed persons at the time of the settlement of debt issued by the debtor are determined in respect of the debtor before taking into account agreements under section 80.04 in respect of that settlement, new subsection 80(14.1) corresponds very closely to existing paragraph 80(14)(a).

More specifically, the "residual balance" under subsection 80(14) at any time in a taxation year in respect of a commercial obligation issued by a debtor is computed as follows:

- ADD, under paragraph 80(14)(a), the "gross tax attributes" of directed persons at that time in respect of the debtor;

- SUBTRACT, under paragraph 80(14)(b), the amount determined for A in subsection 80(13) in respect of the settlement; and

- Where there has been a previous settlement in the same year of a commercial obligation issued by the debtor, SUBTRACT under paragraphs 80(14)(c) and (d) all amounts each of which is:

  – the amount, if any, by which the amount determined for A in subsection 80(13) in respect of another such settlement exceeds the amount determined for C in respect of that settlement,

  – the amount determined for A in subsection 80(13) for a directed person of the debtor, to the extent that it arises because of an agreement under section 80.04 in respect of another such settlement, or

  – the amount specified in an agreement under section 80.04 in respect of another such settlement, where the agreement is not with a directed person of the debtor, and

  – with respect to another such settlement, the least of

    (i) the total of all amounts designated under subsection 80(11) in respect of that settlement,

(ii) the residual balance at the time of that settlement, and

*(iii) the amount, if any, by which the sum of the amounts determined for A and B in subsection 80(13) in respect of that settlement exceeds the amount determined for C in respect of that settlement.

New paragraph 80(14)(c) is, in substance, almost identical to existing paragraphs 80(14)(d) and (e). New paragraph 80(14)(d) is, in substance, almost identical to existing paragraph 80(14)(f). The only significant difference is the addition of clause 80(14)(d)(iii), which is denoted by the asterisk above and illustrated in example 5, below.

These amendments apply to taxation years that end after February 21, 1994.

The following examples illustrate the operation of these amendments. Except for example 5, the same end results are achieved under the existing and new provisions.

EXAMPLE 1

Debtco issued a commercial obligation to a bank for $150,000. Debtco's only asset is the shares of the capital stock of Opco (a wholly-owned subsidiary that is a taxable Canadian corporation), which have an adjusted cost base (ACB) to Debtco of $120,000. Opco's only asset is depreciable property of a prescribed class having an undepreciated capital cost (UCC) of $70,000. The full $150,000 of debt is forgiven. Debtco enters into an agreement with Opco under section 80.04 in which the amount specified is $20,000 and designates $80,000 under subsection 80(11) as a reduction in the ACB of the Opco shares. Opco uses the $20,000 to reduce its UCC from $70,000 to $50,000.

Results:

1. The residual balance at the time of the settlement is nil, determined as follows:

- *Add $70,000, which is the $70,000 UCC, and*

- *Subtract $70,000 under paragraph 80(14)(b), which is the amount determined for A in subsection 80(13) ($150,000 - $80,000)*

2. As a consequence, the amount included under subsection 80(13) in computing Debtco's income is equal to $37,500, determined as follows:

- *Add $70,000 under the description of A in subsection 80(13), which is the remaining unapplied forgiven amount ($150,000 - 80,000),*

- *Add nil under the description of B in subsection 80(13), as the residual balance is nil,*

- *Subtract the $20,000 specified amount under the description of C in subsection 80(13), and*

- *Multiply the remainder ($50,000) by 3/4.*

EXAMPLE 2

Same as example 1, except that the amount designated under subsection 80(11) is $100,000 rather than $80,000.

Results:

1. The residual balance at the time of the settlement is $20,000, determined as follows:

- *Add $70,000, which is the $70,000 UCC, and*

- *Subtract $50,000 under paragraph 80(14)(b), which is the amount determined for A in subsection 80(13) ($150,000 - $100,000).*

2. As a consequence, the amount included under subsection 80(13) in computing Debtco's income is equal to $37,500, determined as follows:

- *Add $50,000 under the description of A in subsection 80(13), which is the remaining unapplied forgiven amount ($150,000 - 100,000),*

- *Add the $20,000 residual balance under the description of B in subsection 80(13),*

- *Subtract the $20,000 specified amount under the description of C in subsection 80(13), and*

- *Multiply the remainder ($50,000) by 3/4.*

EXAMPLE 3

Debtco issued two commercial obligations to a bank for $90,000 and $60,000. Debtco's only asset is the shares of the capital stock of Opco (a wholly-owned subsidiary that is a taxable Canadian corporation), which have an adjusted cost base (ACB) to Debtco of $120,000. Opco's only asset is depreciable property of a prescribed class having an undepreciated capital cost (UCC) of $70,000. The $90,000 debt is fully forgiven. Subsequently, in the same taxation year, the $60,000 debt is forgiven. Debtco enters into an agreement with Opco under section 80.04 in which the amount specified is $20,000 with respect to the first settlement. In addition, an amount of $20,000 is designated under subsection 80(11) with respect to the first settlement. Subsequently, an amount of $60,000 is designated under subsection 80(11) with respect to the second settlement. (Note: this example is, in substance, the same as example 1.)

Results:

1. As in example 1, the residual balance at the time of the first settlement is nil. This is computed as follows:

- *Add $70,000, which is the $70,000 UCC, and*

- *Subtract $70,000 under paragraph 80(14)(b), which is the amount determined for A in subsection 80(13) ($90,000 - $20,000).*

2. The residual balance at the time of the second settlement is also nil, computed as follows:

- *Add $50,000, which is the $70,000 UCC minus the $20,000 amount specified in an agreement under section 80.04 before that time, and*

- *Subtract $50,000 under subparagraph 80(14)(c)(i), which is the amount determined for A in subsection 80(13) in respect of the settlement before that time ($90,000-$20,000) that exceeds the amount determined for C in that subsection in respect of that settlement ($20,000).*

3. Given the residual balance in each case is equal to nil, the income inclusion under subsection 80(13) is equal to $37,500 with respect to the first settlement (3/4 x ($90,000 - $20,000 - $20,000)) and $0 with respect to the second settlement. This is consistent with example 1. In the event that a higher total amount is designated under subsection 80(11), the results will be consistent with example 2.

EXAMPLE 4

Debtco issued a commercial obligation to a bank for $200,000. Debtco's only asset is the shares of the capital stock of Opco (a wholly-owned subsidiary that is a taxable Canadian corporation), which have an adjusted cost base (ACB) to Debtco of $220,000. Opco's only asset is depreciable property of a prescribed class having an undepreciated capital cost (UCC) of $120,000. The full $200,000 of debt is forgiven. Debtco enters into an agreement with Opco under section 80.04 in which the amount specified is $30,000 and designates $200,000 under subsection 80(11) as a reduction in the ACB of the Opco shares. Opco does not use the $30,000 to reduce its UCC.

Results:

1. The residual balance at the time of the settlement is $120,000, which is the $120,000 UCC. No amount is subtracted under paragraph 80(14)(b) because the remaining unapplied amount under the description of A in subsection 80(13) is nil ($200,000-$200,000).

2. As a consequence, the amount included under subsection 80(13) in computing Debtco's income is equal to $67,500, determined as follows:

- *Add nil under the description of A in subsection 80(13), which is the remaining unapplied forgiven amount ($200,000-$200,000),*
- *Add $120,000 under the description of B in subsection 80(13), as it is the lesser of the amount designated under subsection 80(11) ($200,000) and the residual balance ($120,000),*
- *Subtract the $30,000 specified amount under the description of C in subsection 80(13), and*
- *Multiply the remainder ($90,000) by 3/4.*

EXAMPLE 5

Debtco issued two commercial obligations to a bank for $90,000 and $110,000. Debtco's only asset is the shares of the capital stock of Opco (a wholly-owned subsidiary that is a taxable Canadian corporation), which have an adjusted cost base (ACB) to Debtco of $220,000. Opco's only asset is depreciable property of a prescribed class having an undepreciated capital cost (UCC) of $120,000. The $90,000 debt is fully forgiven. Subsequently, in the same taxation year, the $110,000 debt is forgiven. Debtco enters into an agreement with Opco under section 80.04 in which the amount specified is $30,000 with respect to the first settlement. Opco does not use the $30,000 to reduce UCC. In addition, an amount of $90,000 is designated under subsection 80(11) with respect to the first settlement. Subsequently, an amount of $110,000 is designated under subsection 80(11) with respect to the second settlement. Note: this example is, in substance, the same as example 4.

1. As in example 4, the residual balance at the time of the settlement is $120,000, which is the $120,000 UCC. No amount is subtracted under paragraph 80(14)(b) because the remaining unapplied amount under the description of A in subsection 80(13) is nil ($90,000-$90,000).

2. The residual balance at the time of the second settlement is $30,000, computed as follows:

- *Add $120,000, which is the $120,000 UCC (the $30,000 amount specified in the agreement under section 80.04 in respect of the first settlement is not relevant under subsection 80(14.1) because Subco did not use it to reduce the UCC),*

- *Subtract $30,000 under subparagraph 80(14)(c)(ii), which is the amount determined for A in subsection 80(13) for Subco because of the agreement made under section 80.04 in respect of the first settlement, and*

- *Subtract $60,000 under paragraph 80(14)(d)(iii), which is the least of the amount designated under subsection 80(11) in respect of the first settlement ($90,000), the residual balance at the time of the first settlement ($120,000) and the sum of the amounts determined for A and B in subsection 80(13) in respect of the first settlement minus the amount determined for C in respect of first settlement ($0 + $90,000 - $30,000 = $60,000).*

3. The income inclusion under subsection 80(13) is equal to $45,000 with respect to the first settlement (3/4 x ($0 + $90,000 - $30,000)) and $22,500 with respect to the second settlement (3/4 x ($0 + $30,000 - $0)). This is consistent with example 4.

Subclause 36(5)

ITA
80(17)

Subsection 80(17) of the Act applies in certain cases where a deduction is claimed under section 61.3 in computing the income of a corporation. Subsection 80(17) is designed to provide a corporation which claims a deduction under section 61.3 with an incentive to enter into agreements under section 80.04 with related corporations and partnerships in order to have the tax attributes of those corporations or partnerships reduced.

In order to reduce the complexity associated with the debt forgiveness rules, subsection 80(17) is being repealed.

This amendment applies to taxation years that end after February 21, 1994.

Clause 37

Definitions

ITA
80.03

Section 80.03 sets out rules that are designed to preserve the effectiveness of the debt forgiveness rules under section 80, in the event that section 80 has resulted in a reduction of the adjusted cost base of a share, partnership interest or trust interest.

Subclause 37(1)

ITA
80.03(1)

Subsection 80.03(1) of the Act defines a number of expressions used in the section.

Subsection 80.03(1) is amended to eliminate the definition of "taxable dividend" for the purposes of section 80.03. This amendment is strictly consequential on the repeal of subsection 80.03(4), described below.

This amendment applies to taxation years that end after February 21, 1994.

Subclause 37(2)

ITA
80.03(4) to (6)

Subsections 80.03(4) to (6) of the Act apply where a corporation disposes of capital property that is a share or a partnership or trust interest. In certain cases, tax consequences arise for the corporation based on adjustments to the adjusted cost base to the corporation arising because of section 80 and dividends received by the corporation.

In order to reduce the complexity associated with the debt forgiveness rules, subsections 80.03(4) to (6) are being repealed. It is noted, however, that the general anti-avoidance rule in section 245 may apply to some of the cases where subsection 80.03(4) was applicable.

These amendments apply to taxation years that end after February 21, 1994.

Subclauses 37(3) and (4)

ITA
80.03(7)

Subsection 80.03(7) of the Act allows a person to treat a capital gain that would otherwise arise under subsection 80.03(2) or (4) as a forgiven amount for the purposes of section 80, to the extent that the person so designates. The designation is made in a prescribed form filed with a person's income tax return for the taxation year that includes the time of the disposition that gave rise to the application of subsection 80.03(2) or (4).

Subsection 80.03(7) is amended to eliminate the references to subsection 80.03(4). This amendment is strictly consequential on the repeal of subsection 80.03(4).

This amendment applies to taxation years that end after February 21, 1994.

Clause 38

Agreement re: Settlement of Debt

ITA
80.04

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

Subclauses 38(1) and (2)

ITA
80.04(5) and (5.1)

Subsection 80.04(5) contemplates that property may be acquired by an eligible transferee from the debtor as consideration for such an agreement. Under that subsection, neither the eligible transferee nor the debtor is required to add any amount or benefit in computing income only because of the acquisition of the property or because of the entering into the agreement under section 80.04.

Paragraph 80.04(5)(d) is replaced by new subsection 80.04(5.1). New subsection 80.04(5.1) provides that, for the purpose of Part I of the Act, a benefit is not considered to have been conferred on a debtor as a consequence of an agreement under section 80.04 between the debtor and an eligible transferee. Unlike paragraph 80.04(5)(d), the new subsection applies whether or not property is acquired by an eligible transferee as consideration for entering into an agreement filed under section 80.04.

This amendment applies to taxation years that end after February 21, 1994.

Subclause 38(3)

ITA
80.04(10)

Section 80.04 of the Act provides rules that allow a debtor to enter into an agreement with an eligible transferee in order for the debtor to minimize the tax consequences to the debtor under section 80 from the settlement of a debt issued by the debtor. Subsection 80.04(10) of the Act provides that a debtor is liable to pay all or part of its eligible transferee's taxes, interest and penalties for taxation years ending in the 10 calendar years ending after the settlement of the debt, that is subject of an agreement under section 80.04.

Paragraph 80.04(10)(a) is amended to provide that the debtor is liable only for taxation years ending in the 4 calendar years ending after the settlement of the debt.

This amendment applies to taxation years that end after February 21, 1994.

Clause 39

Dividends from Canadian Corporations

ITA
82(1)

Subsection 82(1) of the Act provides that taxable dividends received by a taxpayer from a corporation resident in Canada are included in computing the taxpayer's income. It also generally provides an extra 1/4 gross-up of the amount of such dividends from taxable Canadian corporations, which is added in computing the income of an individual. Section 121 of the Act provides a dividend tax credit equal to 2/3 of the amount an individual is required to include in income as a gross-up. For this purpose, an individual includes a trust (other than a trust that is a registered charity).

Subsection 82(1) is amended to provide that the gross-up for a taxation year does not apply to taxable dividends received by a trust in the year from a taxable Canadian corporation, to the extent that

such dividends are included in computing the income of a non-resident beneficiary under the trust. As a consequence, the calculation of the trust's dividend tax credit will not be affected by whether or not the trust designates amounts under subsection 104(19) of the Act in respect of non-resident beneficiaries.

The rationale for this amendment is that the dividend tax credit is aimed at Canadian residents, whose income tax rates under Part I are generally higher than the withholding rates for non-residents under Part XIII. The purpose of this amendment is to prevent trusts with non-resident beneficiaries from obtaining access to the dividend tax credit in connection with income allocated to those beneficiaries that has not been flowed-out to those beneficiaries under subsection 104(19).

This amendment applies to taxation years that end after April 26, 1995.

Clause 40

Non-arm's Length Sales of Shares

ITA
84.1(2)

Subsection 84.1(2) of the Act provides, amongst other things, rules for determining a taxpayer's adjusted cost base of shares for the purposes of subsection 84.1(1) of the Act. Subsection 84.1(2) of the Act is restructured.

Subclauses 40(1) and (4)

ITA
84.1(2.01)

Paragraph 84.1(2)(a.2) of the Act is repealed and is included in new subsection 84.1(2.01) of the Act.

New paragraph 84(2.01)(b) treats a share as having been acquired by a taxpayer in a non-arm's length transaction for the purposes of paragraph 84.1(2)(a.1) where the taxpayer has elected under

subsection 110.6(19) to recognize all or part of the gain accrued to February 22, 1994 on the share. This amendment, which applies to the 1994 and subsequent taxation years, ensures that an election under subsection 110.6(19) in respect of a share will not increase the holder's adjusted cost base of the share for the purposes of section 84.1.

New paragraph 84.1(2.01)(c) of the Act provides that for the purpose of paragraph 84.1(2)(a.1) where, at any time after 1971, a share owned by a particular person has, as a result of one or more transactions between other persons not dealing at arm's length, become vested in one of those other persons, the particular person and the other person will be treated, at any time, as not dealing at arm's length with each other. This is so regardless of the fact that the person and the other person may have never coexisted. New paragraph 84.1(2.01)(c) of the Act is clarifying and ensures, amongst other things, that the test for non-arm's length status is continuous running from generation to generation with that continuity being severed only upon an arm's length disposition. New paragraph 84.1(2.01)(c) of the Act applies in respect of the determination of the adjusted cost base of a share after the ANNOUNCEMENT DATE.

EXAMPLE

> *Assume Ms. A was born in 1980 and that Ms. A is the daughter of Mr. A. Mr. A 's mother (Mrs. A) died in 1979. On her death, Mr. A acquired her shares of MCo. which were owned by Mrs. A at the end of 1971. In 1994, Mr. A disposes of his MCo shares to Ms. A. In July 1996, Ms. A transfers the MCo. shares to her holding company. For the purpose of determining the adjusted cost base of the shares of MCo. to Ms. A, Ms. A and the late Mrs. A are treated as dealing at non-arm's length. Therefore, the adjusted cost base of the MCo. shares will be reduced by the amount, if any, of the excess of the V-Day value of the shares over the cost of the shares to the late Mrs. A on January 1, 1972.*

Subclauses 40(2), (3) and (5)

ITA
84.1(2.2)

Paragraphs 84.1(2)(c) and (e) are repealed and included in new subsections 84.1(2.2) of the Act.

Clause 41

Transfer of property to corporation by shareholder

ITA
85

Section 85 applies to transfers on a tax-deferred basis of certain properties by a taxpayer to a taxable Canadian coproration in exchange for shares.

Subclause 41(1)

Transfer of property to corporation from partnership

ITA
85(2)

Subsection 85(2) provides that the rules in subsection 85(1) will apply to and allow a partnership to transfer certain properties to a taxable Canadian corporation on a tax-deferred basis in exchange for shares of the corporation. The amendment changes the scope of subsection 85(2) to make it more closely parallel the scope of subsection 85(1.1). A property that is inventory and an interest in real property or an option in respect of real property is excluded from subsection 85(2), as is a mark-to-market property held by a financial institution. However, a specified debt obligation held by a financial institution is expressly included.

The amendment applies to dispositions that occur after ANNOUNCEMENT DATE.

Subclauses 41(2) to (5)

ITA
85(4) to (5.1)

Subsection 85(4) of the Act applies where a taxpayer disposes of capital property or eligible capital property to a corporation that is controlled by the taxpayer, the taxpayer's spouse or a person or group of persons by whom the taxpayer is controlled. Although, as discussed below, this subsection is to be repealed with effect after April 26, 1995, an amendment is being made to correct its application for the period between June 1988 and April 26, 1995.

Specifically, paragraph 85(4)(b) provides that, where the transferor of property owns shares of the transferee, any capital loss or deduction under paragraph 24(1)(a) that is denied because of subsection 85(4) is to instead be added to the transferor's adjusted cost base of those shares. Paragraph 85(4)(b) currently provides that addition is to equal the difference between the cost amount of the property and the eligible capital amount resulting from its sale. However, the cost amount of eligible capital property represents its full cost rather than only the 75% thereof that is added to a taxpayer's cumulative eligible capital, whereas the eligible capital amount arising on the disposition of eligible capital property takes into account only 75% of the proceeds therefrom. This amendment corrects paragraph 85(4)(b) by providing that any cost base addition arising in respect of a transfer of eligible capital property is to be limited to the difference between its cost amount to the transferor and 4/3 of the resulting addition to the transferor's eligible capital amount.

The repeal of subsection 85(4) reflects the addition of new subsection 14(12), which applies with respect to transfers of eligible capital property, and of new subsections 40(3.4) and (3.6), which apply to transfers of non-depreciable capital property. Subsection 85(5.1), which applied to transfers of depreciable capital property, is also repealed, its replacement being found in new subsection 13(21.2). A consequential amendment to subsection 85(5) of the Act deletes the reference to subsection 85(5.1).

The repeal of subsections 85(4) and (5.1), and the amendment to subsection 85(5), apply to dispositions that take place after April 26, 1995, subject to certain exceptions. These are found in

clause 156, and generally exclude transactions in progress before April 27, 1995. Readers should refer to the notes to clause 156 for more detail.

Clause 42

Amalgamations

ITA
87

Section 87 of the Act sets out rules that apply where there has been an amalgamation of two or more taxable Canadian corporations to form a new corporation.

Subclause 42(1)

ITA
87(2)(g.3) and (g.4)

In general terms, new subsections 13(21.2), 14(12) and 40(3.4), along with amendments to section 18 of the Act, apply where property is transferred to a person with whom the transferor is affiliated (the concept of affiliated persons is introduced in new section 251.1 of the Act), and the tax cost of the property to the transferor exceeds its value at the time of its transfer. Where these conditions exist, any loss that would otherwise arise on the disposition is denied, but can be subsequently recognized when, for example, the transferred property is sold to a person that is not affiliated with the transferor.

New paragraph 87(2)(g.3) of the Act treats a new corporation formed on an amalgamation as a continuation of each of its predecessors for the purpose of applying these subsections to property disposed of before the amalgamation took place. Thus a new corporation created on an amalgamation would, for example:

- be entitled under subsection 13(21.2) to make annual capital cost allowance claims (or to claim a terminal loss) in respect of a loss denied to a predecessor on the transfer of depreciable property;

- be considered under subsection 14(12) to own eligible capital property in respect of a business that was carried on by a predecessor; and,

- with respect to each of subsections 13(21.2), 14(12), 18(15) and 40(3.4), be permitted to recognize any loss of a predecessor that was denied under those provisions where control of the new corporation is acquired.

New paragraph 87(2)(g.4) of the Act provides that for the purposes of the deemed share ownership rule in new paragraph 40(3.6)(c) of the Act, the new corporation formed on an amalgamation is treated as the same as, and a continuation of, each predecessor corporation. For more information, readers should refer to the notes to new subsection 40(3.6).

These amendments apply to amalgamations that occur after April 26, 1995. Under paragraph 88(1)(e.2), they will also apply to windings-up under subsection 88(1) that begin after that date.

Subclause 42(2)

ITA
87(2)(j.91)

A corporation that is liable to tax under Part I.3 of the Act for a taxation year may deduct in computing that liability its Canadian surtax payable for the year, and may deduct any unused surtax credits against its Part I.3 liability for any of the seven following and three previous years. Similarly, a corporation liable to tax under Part VI of the Act can reduce that liability by its Part I tax payable for the year, and can carry any excess Part I liability forward seven and back three years. For the purposes of these carryforwards, paragraph 87(2)(j.91) of the Act treats the new corporation formed on an amalgamation as the same corporation as, and a continuation of, each of its predecessors. The paragraph is amended to clarify that it affects neither the fiscal period of any corporation nor the tax payable by any predecessor corporation. New paragraph 87(2)(j.91) applies to amalgamations occurring after April 26, 1995 and, by virtue of paragraph 88(1)(e.2) of the Act, to windings-up beginning after that date.

Subclause 42(3)

ITA
87(2)(l.21)

Paragraph 87(2)(l.21) of the Act provides that section 61.3 and subsection 80.01(10) apply to an amalgamated corporation as if the amalgamated corporation were the same as, and a continuation of, each of the predecessor corporations.

Paragraph 87(2)(l.21) is amended to add a reference to the definition "unrecognized loss" in subsection 80(1), as a consequence of which an unrecognized loss from a disposition of a property by a predecessor corporation can survive an amalgamation under section 87 and be used under subsection 80(13) by the corporation formed on the amalgamation.

This amendment applies to taxation years that end after February 21, 1994.

Subclause 42(4)

ITA
87(2)(x)

For the purposes of the stop-loss rules in subsections 112(3) to (4.3) of the Act, paragraph 87(2)(x) treats dividends received on a share by a predecessor corporation as having been received on the share by the new corporation with the same character and deductibility they had for the predecessor corporation. Paragraph 87(2)(x) is modified in three ways.

First, the purposes for which the provision applies are changed to correspond to the renumbering of the stop-loss rules in section 112 of the Act.

Second, subparagraph 87(2)(x)(ii) is amended by changing the references to capital dividend and life insurance capital dividend to a dividend (other than a taxable dividend). This change ensures that all dividends (other than dividends deemed to be taxable dividends because of subsection 83(2.1)) in respect of which an election was made under subsection 83(2) of the Act – and not simply those which

were supported by the dividend-paying corporation's capital dividend account – are captured by the effect of this paragraph.

Existing paragraph 87(2)(x) does not take into account the period of ownership of the share by a predecessor corporation. Consequently, the stop-loss rules may apply if the new corporation disposes of the share within 365 days of the amalgamation although the rules would not have applied had a predecessor corporation disposed of the share. Therefore, the third change to paragraph 87(2)(x) adds new subparagraph 87(2)(x)(iii) to provide that a new corporation is deemed to have owned a share throughout the period during which the share was owned by a predecessor corporation.

The effect of the coming-into-force provision for amended paragraph 87(2)(x) is that the first two amendments described above will apply to dispositions that occur after April 26, 1995, and the third amendment will apply to the 1994 and subsequent taxation years.

Subclause 42(5)

ITA
87(2)(y.1)

Paragraph 87(2)(y.1) of the Act provides for the flow-through of the net "preferred-earnings amount" of each predecessor corporation to the new corporation formed on an amalgamation. A corporation's preferred-earnings amount was defined in former subsection 181(2) of the Act and was a measure of a corporation's income earned in taxation years beginning after 1982 that was subject to the reduced small business rate of tax. Dividends paid out of the preferred-earnings amount were subject to a 12.5% corporate distributions tax under former Part II of the Act. Paragraph 87(2)(y.1) is repealed as a consequence of the previous repeal of the Part II tax. This amendment applies to taxes payable for taxation years that begin after 1986.

Subclause 42(6)

ITA
87(2)(bb)

Paragraph 87(2)(bb) of the Act provides rules that apply in calculating the capital gains dividend account and refundable capital gains tax on hand of a mutual fund corporation or an investment corporation formed as a result of an amalgamation.
Paragraph 87(2)(bb) is being amended to update the reference therein to the components of the definition "capital gains dividend account" in subsection 131(6). This amendment applies to amalgamations that occur after 1991. However, where an amalgamation occurred after 1991 and before February 23, 1994, a transitional provision applies that provides the appropriate reference to the components of the definition "capital gains dividend account" in subsection 131(6) as it read during that period.

ITA
87(2)(bb.1)

New paragraph 87(2)(bb.1) is added to the Act as a consequence of the elimination of the $100,000 lifetime capital gains exemption for dispositions that occur after February 22, 1994 and the introduction of the election mechanism in subsection 110.6(19) for recognizing gains accrued to the end of that day. If an individual elects to recognize a capital gain accrued to that time on an interest in, or a share of a capital stock of, a flow-through entity (as defined in subsection 39.1(1)), the amount of the gain is credited to a special account referred to as the individual's exempt capital gains balance in respect of the entity. Claims may be made against this account to reduce gains that are flowed out to the individual by the entity for taxation years before 2005 and gains realized on dispositions of interests in or shares of the entity in those years.

New paragraph 87(2)(bb.1) provides that the exempt capital gains balance of an individual in respect of a flow-through entity that is an investment corporation, a mortgage investment corporation or a mutual fund corporation before an amalgamation in which the corporation is a predecessor corporation is carried over to the new corporation formed on the amalgamation provided that the new

corporation is also an investment corporation, a mortgage investment corporation or a mutual fund corporation, respectively.

New paragraph 87(2)(bb.1) applies in respect of amalgamations that occur after 1993.

Subclause 42(7)

ITA
87(2)(qq)

Paragraph 87(2)(qq) of the Act treats the corporation formed on an amalgamation as the same corporation as, and a continuation of, each of its predecessors, for the purposes of computing the new corporation's investment tax credits and employment tax credits. The paragraph is amended, for amalgamations occurring after April 26, 1995, to delete the reference to employment tax credits and to clarify that the provision affects neither the fiscal period of any corporation nor the tax payable by any predecessor corporation.

Subclause 42(8)

ITA
87(2.1)(b)

Subsection 87(2.1) of the Act allows the corporation formed on an amalgamation to deduct the unclaimed losses of its predecessors, subject to the restrictions on the use of losses imposed by section 111 (loss carryovers) and subsection 149(10) (changes in tax status) of the Act. This amendment, which is consequential on the amendment of subsection 149(10), replaces the reference in paragraph 87(2.1)(b) to paragraph 149(10)(d) with a reference to paragraph 149(10)(c). The amended paragraph applies to any corporation that becomes or ceases to be exempt from tax after April 26, 1995.

Subclause 42(9)

ITA
87(2.11)

Subsection 87(2.11) of the Act treats the corporation formed on what is commonly known as a "vertical amalgamation" (the amalgamation

of a corporation and one or more of its subsidiary wholly-owned corporations) as the same corporation as, and a continuation of, the former parent corporation, for the purposes of section 111 and Part IV of the Act. By allowing losses incurred by the amalgamated corporation to be carried back to the former parent, subject to the rules in section 111, the provision conforms the effect of a vertical amalgamation to what would have resulted if the predecessor subsidiary had instead been wound up into its parent under subsection 88(1) of the Act.

This amendment adds to the list of purposes for which the new corporation will be treated as the same corporation as, and a continuation of, the former parent company. In addition to section 111 and Part IV of the Act, these include: section 126 (foreign tax credits), subsections 127(5) to (12.3) (investment tax credits), subsections 181.1(4) to (7) (deduction of unused surtax against Part I.3 tax) and subsections 190.1(3) to (6) (deduction of unused Part I tax against Part VI tax). The amendment thus allows various tax attributes to move from the surviving corporation – the one formed on the amalgamation – back to the predecessor parent, much as they could if the companies had reorganized through a winding-up.

This amendment applies to amalgamations occurring after April 26, 1995.

Subclause 42(10)

ITA
87(9)(a.5)

Subsection 87(9) of the Act provides rules for "triangular amalgamations" – amalgamations in which shares of a parent corporation are issued in exchange for shares of the merging predecessors. New paragraph 87(9)(a.5) of the Act provides that for the purpose of applying new subsection 87(10) of the Act, a share issued by the parent on a triangular amalgamation is treated as having been issued by the new corporation. New subsection 87(10) of the Act is a rule that deems certain shares to have been listed on a prescribed stock exchange. For more information, readers should consult the notes to that provision.

New paragraph 87(9)(a.5) applies to amalgamations that occur after April 26, 1995.

Subclause 42(11)

Share deemed listed

ITA
87(10)

As a result of changes to the definition of "taxable Canadian property" in paragraph 115(1)(b) of the Act, shares of a public corporation that are not listed on a prescribed stock exchange are taxable Canadian property. In the course of certain amalgamations, a predecessor corporation's listed shares may temporarily be replaced by unlisted shares of the new corporation. New subsection 87(10) of the Act treats those temporary shares as having themselves been listed, provided the new corporation is a public corporation and the new shares are redeemed, acquired or cancelled by the new corporation within 60 days after the amalgamation. This deemed listing applies for the purposes of subsections 115(1) and 116(6) of the Act, and for the definition of "qualified investment" in subsections 146(1) and 146.3(1) and section 204 of the Act.

New subsection 87(10) applies to amalgamations that occur after April 26, 1995. Where an amalgamation occurs before July 1996, new subsection 87(10) applies whether or not the new corporation formed on the amalgamation is a public corporation (assuming the other requirements of the provision are met).

Vertical Amalgamations

ITA
87(11)

Subsection 87(11) of the Act is a new provision generally effective in respect of a vertical amalgamation occurring after 1994 to which subsection 87(1) applies. These provisions provide a new corporation formed on the amalgamation of a parent and one or more of its subsidiary wholly-owned corporations with the option of increasing its cost of certain capital property acquired by it on the amalgamation. This increase in the new corporation's cost is the same

as the increase that would be available to the parent if the subsidiary had been wound up into the parent and subsection 88(1) of the Act had applied to the winding-up .

New subsection 87(11) of the Act relies upon subsection 88(1) and new subsection 88(1.7) of the Act to determine the type of property that qualifies for the increase and the amount of the increase in respect of each such property. As well, new subsection 87(11) relies upon subsection 88(1) to determine the parent's proceeds of disposition arising from the parent's disposition of the subsidiary's shares on the amalgamation. New subsection 87(11) of the Act applies to amalgamations that occur after 1994 unless the amalgamation occurs before ANNOUNCEMENT DATE and the new corporation elects not to have it apply to the amalgamation in the tax return for the year of the parent that ended immediately before the amalgamation or within 90 days after any assessment or reassessment of tax payable for that year.

Clause 43

Winding-up of a Corporation

ITA
88(1)

Section 88 of the Act deals with the tax consequences arising from the winding-up of a corporation. Subsection 88(1) provides rules that 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.

Subclauses 43(1) and (2)

ITA
88(1)(c)(vi)

Paragraph 88(1)(c) of the Act provides that the cost to the parent corporation of each property distributed to it on the winding-up of the subsidiary is equal to the subsidiary's proceeds of disposition of the property plus, where the property is not an "ineligible property", an

amount determined under paragraph 88(1)(d) of the Act in respect of that property. An ineligible property is defined in paragraph 88(1)(c) and consists of four types of property. The fourth type of property stops taxpayers from circumventing the restrictions against the so-called "purchase butterfly" reorganization in subsection 55(3.1) of the Act by means of a series of transactions that effectively result in a sale of part of a corporation's assets to an arm's length corporation on a tax-deferred basis.

Subparagraph 88(1)(c)(vi) of the Act which describes the fourth type of ineligible property targets property that is subsequently disposed of by the parent as part of the series of transactions in which the parent acquired control of the subsidiary and the property, or any substituted property, is acquired by one of the following:

A. any person (other than a specified person) who, at any time during the series and before the parent acquired control of the subsidiary, was a specified shareholder of the subsidiary,

B. two or more persons (other than specified persons) who, at any time during the series and before control of the subsidiary was last acquired by the parent, owned, in total, such number of shares as would, if they were owned by one person, make that person a specified shareholder of the subsidiary,

C. a corporation (other than a specified person) of which any person who was a specified shareholder of the subsidiary is a specified shareholder, or

D. a corporation (other than a specified person) where persons described in B whose shares, if owned by one person, would have made that person a specified shareholder of the corporation.

New subparagraph 88(1)(c)(vi) of the Act broadens the scope of the fourth type of ineligible property to include all property distributed to the parent on the winding-up of the subsidiary where as part of the series of transactions or events that includes the winding-up any property distributed to the parent on the winding-up, or any other property acquired in substitution thereof, is acquired by a person described in any of A to D above. New subparagraph 88(1)(c)(vi) of the Act applies to windings-up that begin after ANNOUNCEMENT DATE.

Sub-subclause 88(1)(c)(vi)(B)(III)2 of the Act describes the corporation referred to in D above. This sub-subclause is amended to restrict its application to those situations in which shares of the corporation acquiring the property were acquired by the shareholder as part of the series of transactions that includes the winding-up of the subsidiary. This provision applies to windings-up that begin after November 1994.

Subclause 43(3)

ITA
88(1)(c.2)

Paragraph 88(1)(c.2) of the Act sets out rules for the purposes of that paragraph and subparagraph 88(1)(c)(vi).

Paragraph 88(1)(c.2) of the Act is amended effective for windings-up that begin after November 1994 by adding new subparagraph 88(1)(c.2)(iii). This subparagraph provides that for the purpose of subparagraph 88(1)(c)(vi), the definition of "specified shareholder" in subsection 248(1) of the Act is to be read as including a reference to "or of any other corporation that is related to the corporation and that has a direct or indirect interest in any issued shares of any class of the capital stock of the corporation" rather than of the reference to "or of any corporation that is related to the corporation" New subparagraph 88(1)(c.2)(iii) of the Act ensures that in determining whether a person is a specified shareholder of a corporation for the purposes of subparagraph 88(1)(c)(vi) only shareholdings "above" the corporation and not "below" the corporation are to be considered. In other words, in determining a person’s specified shareholder status in a corporation, you consider the person’s shareholdings in related corporations that have a direct or indirect interest in the corporation.

Subclause 43(4)

ITA
88(1)(c.3)

Subparagraph 88(1)(c)(vi) of the Act treats a property acquired by the parent on the winding-up of a subsidiary as an ineligible property where the property is subsequently disposed of by the parent as part

of the series of transactions in which the parent acquired control of the subsidiary and the property, or any property substituted therefor, is acquired by a person described in A to D in the commentary on subparagraph 88(1)(c)(vi) of the Act. New paragraph 88(1)(c.3) of the Act applies for the purposes of clause 88(1)(c)(vi)(B). New paragraph 88(1)(c.3) provides that property acquired by a person the fair market value of which is

- wholly or partly attributable to a particular property or properties (other than certain shares of the purchaser/parent), or
- determinable primarily by reference to the fair market of a particular property or properties , or to any proceeds from the disposition of a particular property or properties

will be considered to be property acquired by the person in substitution for the particular property or properties. Money received as consideration for the disposition of a particular property or properties will not be considered to be property acquired in substitution therefor.

An example of property the fair market value of which is determinable primarily by reference to the fair market value of a particular property would be a share or debt the terms of which provide for a value that is dependent upon or tracks the proceeds from the disposition of the particular property. In addition, in a situation where at the end of the series the vendor holds a majority of the shares of a corporation substantially all of the value of which is attributable to property distributed on the winding-up, the value of those shares will be considered to be determinable primarily by reference to the fair market value of that property.

New paragraph 88(1)(c.3) applies to windings-up that begin after February 21, 1994, however a transitional rule is provided for windings-up that begin before ANNOUNCEMENT DATE + 1.

ITA
88(1)(c.4)

New paragraph 88(1)(c.4) of the Act provides that for the purpose of subparagraph 88(1)(c)(iii) of the Act both a leasehold interest in a depreciable property and an option to acquire a depreciable property

are depreciable properties. Therefore, an option to acquire a depreciable property will be an ineligible property for the purposes of paragraph 88(1)(c). New paragraph 88(1)(c.4) of the Act applies to windings-up that begin after ANNOUNCEMENT DATE.

Subclause 43(5)

ITA
88(1)(d)

Paragraph 88(1)(d) of the Act determines for the purpose of paragraph 88(1)(c) the amount by which a parent corporation may increase the cost of capital property acquired by it on the winding-up of its subsidiary. This paragraph also includes an interpretation provision, which provides that where a parent corporation has been formed after the time that any other corporation with which the parent did not deal at arm's length at any time prior to the winding-up was formed, the parent corporation will be considered to have existed since the existence of the other corporation and to have not been dealing at arms' length with the other corporation since that time. This interpretation provision in paragraph 88(1)(d) is repealed effective for windings-up that begin after February 21, 1994 and added to new subsection 88(1.7) of the Act.

Subclause 43(6)

ITA
88(1)(d.1)

Paragraph 88(1)(d.1) provides that certain rules in the Act and in the *Income Tax Application Rules* are not to apply to a winding-up governed by subsection 88(1). This amendment deletes the reference in paragraph 88(1)(d.1) to subsection 85(5.1), which is being repealed, and adds references to new subsections 13(21.2) and 14(12) of the Act. These changes are, subject to a transitional provision, applicable to windings-up that begin after April 26, 1995.

Subclause 43(7)

ITA
88(1)(d.2) and (d.3)

Paragraph 88(1)(d.2) of the Act applies in determining the time that a taxpayer last acquired control of a subsidiary for the purposes of the rules permitting a parent corporation to obtain, on the winding-up of the subsidiary, an increase in the cost of a capital property (other than an ineligible property) owned by the subsidiary at the time that the parent last acquired control of the subsidiary. This paragraph applies where control of a subsidiary was acquired from a person, or group of persons, with whom the person, or group of persons, who acquired control did not deal at arm's length. Where control of the subsidiary is acquired by the person, or group, because of a bequest or inheritance, the person or group, will be considered to have dealt at arm's length with the person who bequeathed the shares of the subsidiary.

New paragraphs 88(1)(d.2) and (d.3) of the Act ensure that if control of a subsidiary corporation is acquired by a person or group (the "acquiror") as a consequence of the death of an individual, the acquiror will be considered to have last acquired control of the subsidiary immediately after the individual's death from a person who dealt at arm's length with the acquiror. New paragraphs 88(1)(d.2) and (d.3) of the Act apply to windings-up that begin after December 20, 1991.

Subclauses 43(8) and (9)

ITA
88(1)(e.2)

Paragraph 88(1)(e.2) of the Act provides for the flow-through of a subsidiary's net "preferred-earnings amount" to its parent on a winding-up to which subsection 88(1) applies. A corporation's preferred-earnings amount was defined in former subsection 181(2) of the Act and was used in determining the amount of corporate distributions tax payable under former Part II of the Act. The reference to subparagraph 87(2)(y.1) in subsection 88(1)(e.2) is deleted, and subparagraphs 88(1)(e.2)(xiv) and (xv) are repealed, as a

consequence of the previous repeal of the Part II tax. These amendments apply on windings-up that commence after June 1995.

Subclause 43(10)

ITA
88(1.7)

Paragraph 88(1)(d) of the Act determines for the purpose of paragraph 88(1)(c) the amount by which a parent corporation may increase the cost of capital property acquired by it on the winding-up of its subsidiary. Paragraph 88(1)(d) also includes an interpretation provision which provides that where a parent corporation has been formed after the time that any other corporation with which the parent did not deal at arm's length at any time prior to the winding-up was formed, the parent corporation will be considered to have existed since the existence of the other corporation and to have not been dealing at arm's length with the other corporation since that time. Effective for windings-up that begin after February 21, 1994, this interpretation provision is removed from paragraph 88(1)(d) and is included in new subsection 88(1.7).

New subsection 88(1.7) is consequential on the 1994 amendments that resulted in the addition of the definition "ineligible property" to paragraph 88(1)(c).

Clause 44

Canadian Corporation

ITA
89(1)

Paragraph (*d*) of the French version of the definition "Canadian corporation" in subsection 89(1) of the Act is amended to correct the reference to the time at which each of the corporations from which a new corporation is formed through the amalgamation, merger or other reorganization of the former corporations has to have been a Canadian corporation. The word "quelconque" is therefore substituted for "donné".

The amendment is effective as of June 15, 1994, that is the date when the discrepancy between the French and English versions of paragraph (*d*) of that definition was introduced.

Clause 45

Disposition of Shares in Foreign Affiliate

ITA
93(4)

Subsection 93(4) of the Act applies where a Canadian taxpayer or a foreign affiliate of a Canadian taxpayer (the "vendor") has acquired shares of one foreign affiliate on the disposition of shares of another foreign affiliate. Any capital loss realized by the vendor on the disposition is denied and added to the vendor's adjusted cost base of the shares of the acquired affiliate.

This amendment deletes the reference in subsection 93(4) to subsection 85(4) (which is being repealed), and adds a reference to new subsection 40(3.3) of the Act (which largely replaces subsection 85(4) insofar as it applied to non-depreciable capital property).

The amendment applies to dispositions that take place after April 26, 1995, subject to certain exceptions. These are found in clause 156, and generally exclude transactions in progress before April 27, 1995. Readers should refer to the notes to clause 156 for more detail.

Clause 46

Offshore Investment Fund Property

ITA
94.1(2)

Section 94.1 of the Act contains an anti-avoidance provision that applies where a taxpayer acquires an "offshore investment fund

property" and certain other conditions are satisfied. Where this is the case, an additional amount is added in computing the taxpayer's income. The additional amount for a taxation year is generally equal to the "designated cost" of the property multiplied by the average prescribed rate of interest for the year, minus any other income of the taxpayer from the property for the year.

The "designated cost" to a taxpayer of an offshore investment fund property is, pursuant to the description of A in the formula in the definition, determined by reference to its cost amount. Because of the description of D in the formula, the "designated cost" of property held by a taxpayer at the end of 1984 (or the end of 1985 where subsection 94.1(3) applies) is increased to the extent that its fair market value exceeded its cost amount at that time.

The description of A is amended in two ways. First, the adjustments to the adjusted cost base of capital property arising because of the debt forgiveness rules in section 80 are to be ignored for the purposes of computing the "designated cost" of the property. This change applies to taxation years ending after April 26, 1995. Second, the cost of a property is to be computed without reference to subparagraph 53(2)(c)(i.3) and new section 143.2 of the Act, which may apply when determining the cost of a taxpayer's partnership interest or the cost of a taxpayer's tax shelter investment, respectively. This change applies after September 26, 1994.

The description of D in the definition is amended, for taxation years that commence after ANNOUNCEMENT DATE, so that it does not apply only to cases in which a taxpayer has held the property since the end of 1984 (or since the end of 1985 where subsection 94.1(3) applies). In other cases, the value determined for D is the total of two amounts. The first amount is the fair market value of the property at the time the taxpayer acquired it minus the cost amount to the taxpayer of the property at that time. The second amount is the total of all amounts that would have been included in the designated cost of the property because of additional amounts that would have been included in the taxpayer's income under this section if the designated cost of the property when originally acquired included the excess of its fair market value at that time over its cost to the taxpayer at that time. This amendment is intended to ensure an appropriate designated cost of an offshore investment fund property where the property is

acquired by the taxpayer at a cost that is less than the property's fair market value.

Clause 47

Foreign Affiliates

ITA
95

Section 95 defines a number of terms and provides certain rules that apply for the purposes of subdivision i of Division B in Part I, which relates to shareholders of non-resident corporations.

Subclauses 47(1) to (4)

ITA
95(1)

"excluded property"

The amendment to paragraph (*a*) of the French version of the definition "excluded property" in subsection 95(1) of the Act clarifies that the reference to the expression "income from an active business" refers to the definition of that expression in subsection 95(1). The expression "revenu provenant d'une entreprise exploitée activement" is therefore substituted for "revenu d'une entreprise exploitée activement", the former expression being defined in subsection 95(1). This amendment applies on Royal Assent.

"foreign accrual property income"

Subsection 94.1(1) of the Act contains an anti-avoidance provision relating to investors in offshore investment funds. That subsection applies where a taxpayer has invested in an offshore investment fund and one of the main reasons for the investment was to reduce or defer the tax liability that would have applied to the income generated from the underlying assets of the fund if such income had been earned directly by the taxpayer. In such a case the taxpayer is required to include an amount in income determined by

applying the prescribed rate of interest to the designated cost of the interest in the fund. This rule also applies, with modifications, in computing the foreign accrual property income of a controlled foreign affiliate of a taxpayer. Those modifications are set out in the description of C in the formula in the definition of "foreign accrual property income" in subsection 95(1) of the Act.

The description of C in the definition "foreign accrual property income" in subsection 95(1) of the Act is being amended to add new paragraphs (c) and (d) thereto.

When subsection 94.1(1) is applied in respect of a taxpayer resident in Canada, paragraph 94.1(1)(a) excludes a controlled foreign affiliate of the taxpayer from the class of non-resident entities that are offshore investment fund properties in respect of which subsection 94.1(1) may apply. This is the case since the controlled foreign affiliate's investment income is already subject to accrual taxation under the provisions relating to foreign accrual property income. Where the description of C in the definition "foreign accrual property income" applies so that subsection 94.1(1) is read as being applicable to a controlled foreign affiliate of a taxpayer resident in Canada (i.e. subsection 94.1(1) is read such that the controlled foreign affiliate is the taxpayer referred to therein) it is appropriate to exclude other controlled foreign affiliates of the taxpayer resident in Canada from the class of non-resident entities that are offshore investment fund properties in respect of which subsection 94.1(1) may apply.

New paragraph (c) of the description of C provides that, in computing the foreign accrual property income of a controlled foreign affiliate of a taxpayer resident in Canada arising under subsection 94.1(1), that subsection does not apply to include an amount in the income of the affiliate in respect of an investment in another controlled foreign affiliate of the same taxpayer resident in Canada. This amendment applies to taxation years that end after November, 1991.

New paragraph (d) of the description of C provides a modification to paragraph 94.1(1)(g). Subsection 94.1(1) may include in a taxpayer's income an amount determined by applying the prescribed rate of interest to the designated cost of the interest in the offshore investment fund property. In order to prevent double taxation, the amount required under subsection 94.1(1) to be included in the taxpayer's income is reduced under paragraph 94.1(1)(g) by

distributions or other amounts in respect of the property (other than capital gains) that are required by any other provision of the Act to be included in the taxpayer's income for the relevant year.

Where the description of C applies so that subsection 94.1(1) is read as being applicable to a controlled foreign affiliate of a taxpayer resident in Canada, it is intended that paragraph 94.1(1)(g) reduce the amount included in the controlled foreign affiliate's income only by distributions or other amounts in respect of the property that increase the foreign accrual property income of the affiliate that is included in the income of the taxpayer resident in Canada to the extent of that taxpayer's share thereof. No more is required to prevent double taxation. New paragraph (d) of the description of C is added for greater certainty specifically to exclude from the reduction provided by paragraph 94.1(1)(g) any income of the controlled foreign affiliate of the taxpayer resident in Canada that is not included in the controlled foreign affiliate's foreign accrual property income for the relevant year. For this purpose, the value of C is treated as nil to eliminate circularity in applying this new paragraph.

New paragraph (d) of the description of C in the definition of "foreign accrual property income" in subsection 95(1) applies to taxation years that begin on or after ANNOUNCEMENT DATE.

"lending of money"

The definition of "lending of money" is relevant for the purpose of the definition of "investment business". "Lending of money" by a person (the lender) is defined to include

- the acquisition of trade accounts receivable of another person (the borrower) owing by persons that deal at arm's length with the lender or of interests in such trade accounts receivable,

- the acquisition of loans made by and lending assets of another person (the borrower) owing by persons that deal at arm's length with the lender or of interests in such loans or lending assets,

- the acquisition of foreign resource properties of other persons (the borrower) other than resource properties that are rents or royalties payable by persons that do not deal at arm's length with the lender, and

- the sale by the lender of loans or lending assets or an interest in loans or lending assets where the loans or lending assets were owing by persons that deal at arm's length with the lender.

The definition "lending of money" is being amended such that the definition "lending asset" in subsection 248(1) will be read without the words "but does not include a prescribed security" for the purpose of the lending of money definition. The effect of this amendment is to permit a debt instrument purchased by a foreign affiliate to qualify as a lending asset notwithstanding that it may have represented inventory to the person from whom it was acquired.

This amendment applies to taxation years of a foreign affiliate of a taxpayer that begin after 1994 except that, if there has been a change to the taxation year of a foreign affiliate of a taxpayer in 1994 and after February 22, 1994, this amendment will apply to taxation years of such foreign affiliate that end after 1994. However, where a written request to change the taxation year had been made before February 22, 1994 to the income taxation authority of the country in which the affiliate was resident and subject to income taxation, or where the change in taxation year causes the first taxation year that begins after 1994 to begin earlier than if there had been no change in the affiliate's taxation year, this new definition will remain applicable for taxation years that begin after 1994.

"trust company"

Subsection 95(1) is amended to add thereto the definition of "trust company". This definition will be relevant for the purposes of subparagraph 95(2)(l)(iv), paragraphs 95(2.1)(a) and (2.3)(a) and paragraph (b) of the definition "indebtedness" in subsection 95(2.5). This definition provides that a trust company includes a corporation that is resident in Canada that is a "loan company" as defined in subsection 2(1) of the *Canadian Payments Association Act*.

This new definition applies to taxation years of a foreign affiliate that begin after 1994 except that, where there has been a change to the taxation year of a foreign affiliate of a taxpayer in 1994 and after February 22, 1994, this new definition will apply to taxation years of such foreign affiliate that end after 1994. However, where a written request to change the taxation year had been made before February 22, 1994 to the income taxation authority of the country in

which the affiliate was resident and subject to income taxation, or where the change in taxation year causes the first taxation year commencing after 1994 to commence earlier than if there had been no change in the affiliate's taxation year, this new definition will remain applicable for taxation years that begin after 1994.

Subclause 47(5)

ITA
95(2)(g.1)(ii)

Paragraph 95(2)(g.1) of the Act clarifies that, for the purposes of computing foreign accrual property income (FAPI) of a foreign affiliate, the rules in section 80 will apply with respect to obligations settled or extinguished that relate to FAPI. However, many of the debt forgiveness rules are ignored for this purpose.

Subparagraph 95(2)(g.1)(ii) is amended to eliminate the reference therein to subsection 80(17), consequential on the repeal of that subsection.

This amendment applies to taxation years that end after February 21, 1994.

Clause 48

Partnerships and Their Members

ITA
96

Section 96 of the Act provides general rules for determining the income or loss of a partnership and its members.

Subclauses 48(1) to (4)

ITA
96(2.2)

Subsection 96(2.2) of the Act defines the "at-risk amount" of a limited partner for the purposes of determining deductible losses and

tax credits allocated to the partner. Subsection 96(2.2) is amended in four ways.

The starting point in the calculation of a partner's at-risk amount is the adjusted cost base of the partner's interest. However, if an amount of limited-recourse indebtedness is used to acquire a partner's partnership interest, that amount is deducted from the cost of the interest under subparagraph 53(2)(c)(i.3) or under new subsection 143.2(6) of the Act. Paragraph 96(2.2)(c), however, also reduces the at-risk amount by certain loans owing to the partnership. Paragraph 96(2.2)(c) is, therefore, amended to ensure that the reduction under new subsection 143.2(6) is not deducted a second time under that paragraph in computing the partner's at-risk amount. This amendment applies after November 1994.

Paragraph 96(2.2)(d) provides a reduction in computing a partner's at-risk amount for any amount or benefit to which a limited partner, or a person not dealing at arm's length with the partner, is or may be entitled, where the amount or benefit is intended to protect the partner or person from any loss in respect of the partner's investment. Paragraph 96(2.2)(d) is amended consequential on new section 143.2 of the Act to specifically refer to "a loan or any other form of indebtedness" as being a type of amount or benefit to which that paragraph applies. Subparagraph 96(2.2)(d)(vi) ensures, however, that paragraph 96(2.2)(d) does not apply in respect of an indebtedness where the cost of a limited partner's partnership interest has already been reduced under new subsection 143.2(6). Reference may be made to the commentary accompanying new section 143.2. This amendment applies after November 1994.

Subparagraphs 96(2.2)(d)(iv) and (v) are repealed. Subparagraph 96(2.2)(d)(iv) provided an exception from the application of paragraph 96(2.2)(d) for agreements to dispose of a partnership interest for an amount not exceeding the fair market value of the interest. Subparagraph 96(2.2(d)(vi) provided an exception from the application of paragraph 96(2.2)(d) in the case of certain types of gross revenue guarantees. Generally, the repeal of subparagraphs 96(2.2)(d)(iv) and (v) applies to partnership interests acquired by a taxpayer after April 26, 1995.

The portion of subsection 96(2.2) after subparagraph (d)(vii) is amended consequential on the introduction of new section 143.2 of

the Act. Paragraph 96(2.2)(e) provides that, where a taxpayer described in paragraph 96(2.2)(d) has a right to exchange a partnership interest to which paragraph (d) applies for some other property, the owner of the partnership interest is considered to be entitled to an amount or benefit protecting the partner from loss to the extent of the fair market value of the other property at the time at which the at-risk amount is being computed. This amendment clarifies that paragraph 96(2.2)(e) applies where the taxpayer entitled to exchange all or any part of the partner's partnership interest is a person not dealing at arm's length with the taxpayer. Similarly, paragraph 96(2.2)(f) provides that, where a taxpayer's borrowing in respect of a partnership interest is guaranteed or otherwise backed by a security or similar indemnity, or covenant, provided by the partnership or a person or partnership not dealing at arm's length with the partnership, an at-risk reduction is required under subsection 96(2.2) in respect of the outstanding balance of the borrowing. In addition to clarifying that paragraph 96(2.2)(f) applies where the guarantee is provided to a person not dealing at arm's length to the taxpayer, paragraph 96(2.2)(f) is also amended to remove the reference to the partnership or a person or partnership not dealing at arm's length with the partnership. Generally, this amendment applies to partnership interests acquired after April 26, 1995.

Subclause 48(5)

ITA
96(2.4)

Subsection 96(2.4) of the Act provides an extended definition of "limited partner" which is relevant for the purposes of restrictions on partnership investment tax credits and losses.

In addition to grammatical changes to subsection 96(2.4), paragraph 96(2.4)(b) is amended to clarify its application in circumstances where a member of a partnership, or a person not dealing at arm's length with the member, is entitled to receive an amount or obtain a benefit referred to in certain parts of paragraph 96(2.2)(d), either immediately or in the future and either absolutely or contingently. This amendment applies to fiscal periods that end after November 1994.

Subclause 48(6)

ITA
96(3)

Subsection 96(3) of the Act provides rules that apply if a member of a partnership makes an election under certain provisions of the Act for a purpose that is relevant to the computation of the member's income from the partnership. In such case, the election will be valid only if it is made on behalf of all the members of the partnership and the member had authority to act for the partnership.

Subsection 96(3) is amended to treat an election filed by a member under section 15.2 in the same way as other elections referred to in subsection 96(3). This amendment generally applies to fiscal periods that end after December 2, 1992.

Clause 49

Contribution of Property to Partnership

ITA
97

Subsection 97(2) of the Act provides the rules which allow a person to transfer certain types of properties on a tax-deferred "rollover" basis to a partnership. The amendment to this subsection deletes the reference to subsection 85(5.1) (which is being repealed), and adds a reference to new subsection 13(21.2) of the Act (which replaces subsection 85(5.1)).

Subsection 97(3) of the Act currently denies a deduction for any capital loss realized by a majority interest partner on the transfer of property to a partnership. The term "majority interest partner" is defined in subsection 97(3.1).

Subsection 97(3) is being repealed as a consequence of the introduction of new subsection 40(3.3) of the Act. Under subsection 40(3.3), a loss arising on the transfer of property to a partnership of which the transferor is a majority interest partner will continue to be denied at that time. However, that loss will no longer

be added to the adjusted cost base of any interest held by the transferor in the partnership but will, instead, be deferred until the earliest of certain events (described in the commentary to subsection 40(3.3)).

A definition of majority interest partner is also being added to section 248(1) of the Act, thus enabling subsection 97(3.1) to be repealed.

The amendments to section 97 of the Act apply to dispositions that take place after April 26, 1995, subject to certain exceptions. These are found in clause 156, and generally exclude transactions in progress before April 27, 1995. Readers should refer to the notes to clause 156 for more detail.

Clause 50

Disposition of Partnership Interest

ITA
98.1(1)(a)

Section 98.1 of the Act provides rules that apply to a taxpayer who ceases to be a member of a partnership but continues to have a residual interest in the partnership. Paragraph 98.1(1)(a) provides, among other things, that the residual interest will be considered to be an interest in the partnership and the partner will be considered not to have disposed of that interest unless the taxpayer ceases to be a resident of Canada or the taxpayer dies.

Paragraph 98.1(1)(a) is amended, as a consequence of the elimination of the $100,000 lifetime capital gains exemption, to add a reference to section 110.6. This amendment deems a disposition of the residual interest to occur where the taxpayer elects to recognize gains in respect of the partnership interest that accrued to the end of February 22, 1994 thereby obtaining the benefit of the exemption in respect of those gains. Amended paragraph 98.1(1)(a) of the Act applies to the 1994 and subsequent taxation years.

Clause 51

Loss Relating to Interest in Partnership

ITA
100(4)

In certain circumstances, subsection 100(4) of the Act reduces the capital loss of a corporate partner arising from the corporation's disposition of a partnership interest. The capital loss otherwise determined is reduced to the extent that the corporation's share of the partnership's loss would have been reduced under subsection 112(3.1) or (4.2) of the Act. Subsections 112(3.1) and (4.2) are stop-loss rules which reduce a partner's share of a partnership loss arising from the partnership's disposition of shares of the capital stock of a corporation. The loss reduction is equal to certain dividends received on the shares and distributed to the partner. Subsections 112(3.1) and (4.2) would not apply to reduce a partner's loss where, instead of the partnership disposing of the corporate shares, the partner disposes of its interest in the partnership. Subsection 100(4) ensures that the capital loss from the disposition of the partnership interest is reduced to reflect the amount of any capital loss that would have been denied in respect of the shares held by the partnership in a notional disposition of the shares at their fair market value. For the purposes of calculating the loss reduction, the provision also treats the partnership's fiscal period as having ended immediately before the disposition of the partnership interest.

The provision is amended so that a loss from the disposition of an interest in a partnership may be reduced where the interest is held by another partnership. The amended provision applies in circumstances where amended subsection 112(3.1) would have applied to reduce a partner's share of a partnership loss arising from the disposition of a share held by any partnership. Since amended subsection 112(3.1) does not reduce losses at the partnership level, a capital loss reduction under amended subsection 100(4) will apply only at the individual or corporate partner level. Accordingly, where amended subsection 112(3.1) would have applied to reduce a partner's share of a partnership loss arising from the disposition of a corporate share held by another partnership, amended subsection 100(4) will reduce the partner's capital loss arising from the disposition of an interest in the second partnership. For the purposes of calculating the loss

reduction, the partnership is treated as having disposed of the corporate shares at their fair market value and the fiscal period of all partnerships are treated as having ended immediately before the disposition of the partnership interest.

Subsection 100(4) is also amended to remove the reference to subsection 112(4.2) of the Act because amended subsection 112(4.2) does not apply to shares held by partnerships.

Amended subsection 100(4) applies to dispositions that occur after April 26, 1995.

Clause 52

Trusts and Their Beneficiaries

ITA
104

Section 104 of the Act provides rules governing the tax treatment of trusts and their beneficiaries.

Subclause 52(1)

ITA
104(4)(a)

Subsection 104(4) of the Act contains provisions that relate to what is generally referred to as the "21-year deemed realization" rule for trusts. Subparagraph 104(4)(a)(i.1), which deals with certain spousal trusts, refers to paragraph 70(5.2)(d) or (f) of the Act. Those paragraphs were amended by the Statutes of Canada 1994, chapter 21 (Bill C-27), which restructured subsection 70(5.2). This amendment to subparagraph 104(4)(a)(i.1) updates the corresponding references so that they correctly reflect that restructuring. It applies to acquisitions and dispositions that occur after 1992, the same period to which the corresponding amendment to subsection 70(5.2) applies.

Subclause 52(2)

ITA
104(6)

Subsection 104(6) of the Act generally permits a trust to deduct in a taxation year any trust income payable to a beneficiary under the trust.

Subsection 104(6) is amended to provide that, once a trust governed by an RRSP or RRIF is no longer exempt from tax after the death of the RRSP or RRIF annuitant, only trust income actually paid to a beneficiary in a taxation year is deductible in computing income. Because subsection 104(13) of the Act does not apply to trusts governed by RRSPs and RRIFs, such amounts paid would be included in income under subsection 146(8) or 146.3(5).

This amendment applies to the 1996 and subsequent taxation years.

Subclause 52(3)

ITA
104(14.01) and (14.02)

Subsection 104(14) of the Act provides for a joint election by a trust and a preferred beneficiary under the trust that allows an amount not exceeding the beneficiary's share of the trust's accumulating income to be deducted in computing the income of the trust and included in computing the income of the beneficiary. Ordinarily, the election is required by subsection 2800(2) of the *Income Tax Regulations* to be filed within 90 days after the end of the trust's taxation year in respect of which the election is made. For the trust's taxation year that includes February 22, 1994, the filing deadline is extended to coincide with the filing deadline for the capital gains election under subsection 110.6(19). Section 104 is amended, applicable to trusts' taxation years that include February 22, 1994, by adding new subsections 104(14.01) and (14.02).

New subsection 104(14.01) extends the filing deadline for a preferred beneficiary election, and allows such an election to be amended or revoked, where the late or amended election or the revocation is made solely because of a late or amended capital gains election or the

revocation of a capital gains election. In these circumstances, the filing deadline for the preferred beneficiary election or the amendment or revocation thereof is extended to coincide with the filing of the late or amended capital gains election or the revocation of the capital gains election, as the case may be.

New subsection 104(14.02) provides that an election or an amended election made in accordance with subsection 104(14.01) will be considered to have been made within the prescribed time for making the election provided for in subsection 104(14), and that the revoked election will be considered, except for the purposes of subsections 104(14.01) and (14.02), to have never been made.

Subclause 52(4)

ITA
104(20)

For the purposes of certain loss limitation rules in the Act, subsection 104(20) of the Act requires a trust to designate the non-taxable dividends that are received by the trust and subsequently distributed to the trust's beneficiaries. The amendment to this provision is consequential on the amendments to the loss limitation rules in section 112 of the Act and the addition of paragraph 107(1)(d) to the Act. The amended loss limitation rules and new paragraph 107(1)(d) are added to the list of purposes of the Act for which designations will be considered to have been made under subsection 104(20).

This amendment applies after April 26, 1995.

Subclause 52(5)

ITA
104(21.01) to (21.03)

Subsection 104(21) of the Act permits a trust to designate in its return of income for the year a portion of its net taxable capital gain as a taxable capital gain of a beneficiary of the trust.

Section 104 is amended, applicable to taxation years that include February 22, 1994, by adding proposed new subsections 104(21.01), (21.02) and (21.03).

New subsection 104(21.01) allows a trust that has filed its return of income for the year which includes February 22, 1994 to subsequently designate an amount under subsection 104(21), or amend or revoke a designation made thereunder, where such designation, amendment or revocation is solely because of changes to the election made under subsection 110.6(19) of the Act and subsection 110.6(25), (26) or (27) of the Act applies to those changes. The trust must file such designation, amendment or revocation, and an amended return for the year, with the amended or revoked election under subsection 110.6(25), (26) or (27) of the Act.

New subsection 104(21.02) provides that a designation, amendment or revocation referred to in subsection 104(21.01) that affects an amount determined in respect of a beneficiary under subsection 104(21.2) may only be made where the trust makes the corresponding changes to an amount designated under subsection (21.2) in respect of the beneficiary. The trust must file these changes with the Minister at the same time as the trust files the changes under subsection 104(21.01).

New subsection 104(21.03) provides that a designation, amended designation or revocation of an amount by a trust under subsection 104(21) or (21.2) that is in accordance with subsection 104(21.01) will be considered to have been made in the trust's return of income for the year that includes February 22, 1994. The designation that is revoked shall be deemed, but for the purposes of this subsection and subsections 104(21.01) and (21.02), to have been made in that return of income.

Clause 53

Income interest in trust

ITA
106(2) and (3)

Subsection 106(2) of the Act applies where a taxpayer disposes of an income interest in a trust. Unless the disposition was as a result of a distribution by the trust, the taxpayer's proceeds of disposition are included in computing the taxpayer's income for the year that includes the disposition. In addition, the taxpayer is treated as not having realized any taxable capital gain or allowable capital loss on the disposition, and the cost to the taxpayer of any property the taxpayer receives as consideration for the income interest is the property's fair market value.

Subsection 106(3) of the Act applies where trust property has been distributed to a beneficiary in satisfaction of all or part of the beneficiary's income interest in the trust. The provision establishes, for greater certainty, that in such a case the trust is treated as having disposed of the property for its fair market value.

Subsections 106(2) and (3) are amended to clarify that they do not apply to a disposition that forms part of a qualifying exchange under section 132.2 of the Act. A qualifying exchange is a tax-deferred transfer of property from one mutual fund to another, and includes the disposition by investors in the transferor fund of their shares or units of that fund in exchange for units of the transferee fund.

To coincide with the introduction of section 132.2, these amendments apply after June 1994.

Clause 54

Dispositions Related to Trusts

ITA
107

Section 107 of the Act provides rules relating to the acquisition and disposition of interests in, and property of, trusts.

Subclause 54(1)

ITA
107(1)(c) and (d)

Subsection 107(1) of the Act contains special rules that are applicable to the disposition of an interest in a trust. Paragraph 107(1)(c) is a "stop-loss" rule which reduces a corporate beneficiary's capital loss from the disposition of an interest in a trust. The loss otherwise realized by the beneficiary is reduced by all dividends designated under subsection 104(19) or (20) of the Act by the trust in respect of the beneficiary. In computing the amount of loss reduction, dividends that reduced a capital loss of the beneficiary from a previous disposition of an interest in the same trust are excluded.

Where a trust realizes a loss on the disposition of a share, the stop-loss rules in section 112 of the Act may apply to reduce the loss otherwise determined by the amount of certain dividends received by the trust on the share. However, these stop-loss rules would not apply where a beneficiary which holds a capital interest in the trust disposes of the interest and realizes a loss that can be attributed to the reduced value of shares held by the trust. Paragraph 107(1)(c) ensures that the appropriate loss reduction is made in such circumstances.

Paragraph 107(1)(c) is amended in its application to corporate beneficiaries so that only taxable dividends that are deductible by the beneficiary will be applied to reduce the capital loss from the disposition. This paragraph is also amended to expand its application to other taxpayers (except for members of partnerships who are dealt with under new paragraph 107(1)(d) of the Act). Where the beneficiary is another trust, all amounts designated under subsection 104(19) and (20) in respect of the beneficiary will reduce

the beneficiary's capital loss from the disposition of an interest in the trust which designated the dividends. Where the beneficiary is a natural person, only amounts designated under subsection 104(20) in respect of the beneficiary will reduce a capital loss from the disposition of an interest in the trust.

New paragraph 107(1)(d) provides similar rules where a partnership realizes a capital loss from a disposition of an interest in a trust. However, since the partnership which disposes of the share is treated as a flow-through entity, the loss reduction is performed at the partner level. The new provision does not apply to reduce the loss of a partnership that is a member of another partnership and applies only where the partner is a corporation or individual. Accordingly, where a partnership is a member of another partnership which realizes a capital loss from the disposition of a trust interest, the loss of the partners of the first partnership may be reduced under paragraph 107(1)(d).

This amendment to subsection 107(1) applies to dispositions that occur after April 26, 1995.

Subclause 54(2)

ITA
107(1.1)

Subsection 107(1.1) of the Act provides, for the purposes of subsection 107(1), that the cost of a capital interest in a trust will be nil, except where the interest is acquired from the previous capital beneficiary of the trust or where the interest is issued to taxpayer for consideration equal to the fair market value of the trust interest. Subsection 107(1.1) is amended as a consequence of the elimination of the $100,000 lifetime capital gains exemption to add a reference to an election made under new subsection 110.6(19) of the Act. This amendment ensures that where a taxpayer makes an election to recognize gains in respect of the taxpayer's capital interest accrued to the end of February 22, 1994 and the trust does not elect in respect of any property of the trust, the taxpayer's cost of that interest will be the amount determined in respect thereof under paragraph 110.6(19)(a). New subsection 107(1.1) applies to the 1994 and subsequent taxation years.

Subclause 54(3)

ITA
107(2)(b)

Paragraph 107(2)(b) of the Act is amended, applicable to the 1994 and subsequent taxation years, to permit an additional amount determined under new subsection 107(2.2) to be included in the cost of property distributed to a beneficiary of a trust described in paragraph (h), (i) or (j) of the definition "flow-through entity" in subsection 39.1(1) in satisfaction of all or a portion of the beneficiary's interest in the trust. A trust described in paragraph (h), (i) or (j) of the definition "flow-through entity" in subsection 39.1(1) is also a prescribed trust under section 4800.1 of the *Income Tax Regulations* for the purpose of subsection 107(2) of the Act.

Subclause 54(4)

ITA
107(2.1)

Subsection 107(2.1) of the Act sets out rules that apply on a distribution of property, by a trust other than a personal or a prescribed trust, in satisfaction of all or part of a beneficiary's capital interest. The subsection is amended to clarify that it does not apply to a disposition that forms part of a qualifying exchange under section 132.2 of the Act. A qualifying exchange is a tax-deferred transfer of property from one mutual fund to another, and includes the disposition by investors in the transferor fund of their shares or units of that fund in exchange for units of the transferee fund.

To coincide with the introduction of section 132.2, this amendment applies after June 1994.

Subclause 54(5)

ITA
107(2.2)

New subsection 107(2.2) of the Act is consequential on the elimination of the $100,000 lifetime capital gains exemption for gains arising on dispositions that occur after February 22, 1994 and the

introduction of the mechanism in subsection 110.6(19) for recognizing gains accrued to that date. Where an individual recognizes a capital gain accrued to that date on an interest in, or a share of the capital stock of, a flow-through entity (as defined in subsection 39.1(1)), the amount of the gain is credited to a special account referred to as the individual's exempt capital gains balance in respect of the entity. Claims may be made against this account to reduce gains that are flowed out to the individual by the entity for taxation years before 2005 and gains realized on dispositions of interests in or shares of the entity for those years.

A beneficiary of a trust described in paragraph (h), (i) or (j) of the definition "flow-through entity" in subsection 39.1(1) may elect under subsection 110.6(19) and establish an exempt capital gains balance in respect of the trust. Distributions of property from such a trust to a beneficiary occur on the rollover basis set out in subsection 107(2).

New subsection 107(2.2) is available to provide an addition to the cost to the beneficiary of each distributed property determined under paragraph 107(2)(b) to permit the beneficiary potentially to benefit from an undepleted exempt capital gains balance in respect of the trust. A beneficiary of a trust described above who receives a distribution of property, other than money, in satisfaction of all or a portion of the beneficiary's interests in the trust may file an election with Revenue Canada in respect of a particular property received. The amount designated in the election in respect of a particular property must not exceed the lesser of two amounts. The first amount is the beneficiary's exempt capital gains balance in respect of the trust for the year minus the total of all reductions in capital gains in the year because of the beneficiary's exempt capital gains balance, 4/3 of all reductions in taxable capital gains in the year because of the beneficiary's exempt capital gains balance and all amounts included because of subsection 107(2.2) in the cost of other property received by the beneficiary in the year. The second amount is the fair market value of the particular property minus the amount deemed to be the cost of the particular property under paragraph 107(2)(b). Thus the cost of a property cannot be bumped to an amount higher than its fair market value under this provision. An election in respect of a property received by the beneficiary must be filed in prescribed form by the beneficiary's filing-due date for the taxation year in which the property was received.

New subsection 107(2.2) applies to the 1994 and subsequent taxation years; however, new subsection 107(2.2) applies only where property is distributed before 2005. After 2004, paragraph 53(1)(p) increases the adjusted cost base to a beneficiary of an interest in a trust to the extent of any undepleted exempt capital gains balance of the beneficiary in respect of the trust. A prescribed form filed under subsection 107(2.2) before the end of the sixth month after the month that the bill that includes this amendment is assented to is deemed to be filed on time.

Subclause 54(6)

ITA
107(6)

Subsection 107(6) of the Act is an anti-avoidance rule designed to deal with an acquisition of a capital interest in a trust that has a property with an accrued loss. Where the property is distributed to the beneficiary in satisfaction of that interest, any loss on a subsequent disposition of the property will be denied to the extent that it can be considered to have accrued while owned by the trust **and** at a time when neither the beneficiary, a person related to the beneficiary nor a partnership of which the beneficiary or a related person was a majority interest partner, had a capital interest in the trust.

This subsection is amended as a consequence of the introduction of the concept of "affiliated persons" in new section 251.1 of the Act. As amended, subsection 107(6) will limit the recognition of a loss only to the extent that it arose when neither the beneficiary nor a person affiliated with the beneficiary had a capital interest in the trust. For this purpose, the affiliation test set out in new section 251.1 is to be read without reference to the extended definition of "controlled" in subsection 251.1(2) of the Act.

Amended subsection 107(6) of the Act applies after April 26, 1995.

Clause 55

Trusts

ITA
108

Section 108 sets out certain definitions and rules that apply for the purposes of subdivision k which deals with the taxation of trusts and their beneficiaries.

Subclauses 55(1) and (2)

ITA
108(1)

"excluded property"

The definition of "excluded property" in subsection 108(1) of the Act is amended to replace its reference to property referred to in clauses 115(1)(b)(v)(A) to (D) of the Act with a reference to taxable Canadian property. This amendment makes no substantive change to the definition, but simplifies and clarifies it. The amended definition applies after April 26, 1995.

"trust"

A "trust" is defined in subsection 108(1) of the Act, for the purposes of the 21-year deemed disposition rules and other specified measures, to exclude certain listed trusts. Under paragraph (e.1) of the definition, trusts governed by eligible funeral arrangements are among the excluded trusts for these purposes.

Paragraph (e.1) of the definition is amended so that cemetery care trusts are likewise excluded, in cases where such trusts might not be otherwise be considered to be trusts governed by eligible funeral arrangements. For further detail, see the commentary below on the definition "cemetery care trust" in subsection 148.1(1).

This amendment applies to the 1993 and subsequent taxation years.

Subclauses 55(3), (4) and (5)

ITA
108(2)

Subsection 108(2) of the Act defines the expression "unit trust". A trust must qualify as a "unit trust" in order to meet the conditions for qualifying as a "mutual fund trust" under subsection 132(6) of the Act.

Paragraph 108(2)(b) is amended so "interests" in real property, as defined by subsection 248(4), are treated in the same manner as real property for the purposes of determining whether a trust is a unit trust. Under subsection 248(4), an "interest" in real property includes a leasehold interest in real property.

New paragraph 108(2)(c) allows certain trusts established before 1994 to qualify as "unit trusts". This provision applies to a trust where the following conditions are satisfied:

- the fair market value of the property of the trust at the end of 1993 was primarily attributable to real property (or an interest in real property, as defined by subsection 248(4));
- the trust was a "unit trust" under subsection 108(2) throughout any calendar year that ended before 1994; and
- the current fair market value of the property of the trust is primarily attributable to cash or investments described in paragraph (a) or (b) of the definition "qualified investment" in section 204 of the Act, real property (or an interest in real property) or any combination of such property.

These amendments apply to the 1994 and subsequent taxation years.

Clause 56

Capital Gains Exemption

ITA
110.6

Section 110.6 of the Act sets out the rules that apply in calculating an individual's entitlement to the lifetime capital gains exemption.

Subclause 56(1)

ITA
110.6(2.1)

Subsection 110.6(2.1) of the Act provides a deduction in respect of net taxable capital gains from the disposition of qualified small business corporation shares. This amendment to paragraph 110.6(2.1)(d) replaces a general reference to "that paragraph" with a specific reference to paragraph 3(b), to eliminate any ambiguity that may arise. The amendment applies to the 1996 and subsequent taxation years.

Subclause 56(2)

ITA
110.6(14)(f)(iii)

Paragraph 110.6(14)(f) of the Act applies for the purposes of the definition of "qualified small business corporation share" in subsection 110.6(1) and treats shares issued by a corporation to a particular person or partnership, except in certain circumstances, as having been owned immediately before their issue to the particular person or partnership by a person who was not related to the particular person or partnership. Paragraph 110.6(14)(f) is amended by adding subparagraph (iii) to provide that shares issued by the corporation as stock dividends on other shares of the capital stock of the corporation will not be subject to this rule. Paragraph 248(5)(b) provides that a share received in payment of a stock dividend on a particular share of the capital stock of a corporation is deemed to be property substituted for that particular share. Therefore, paragraphs (e) and (f) of the definition of "qualified small business corporation

share" in subsection 110.6(1) will be applicable to ensure that the holding period and active business asset tests in that definition operate effectively where shares are received as stock dividends on other shares of the capital stock of a corporation.

The effect of the rule in paragraph 110.6(14)(f) is to require shares, other than those issued in circumstances provided for in the exceptions in subparagraphs (i), (ii) and (iii), to be owned for the full 24 month holding period by the taxpayer or persons or partnerships related to the taxpayer in order to qualify for the $500,000 lifetime capital gains exemption. This rule ensures that the holding period requirement in the "qualified small business corporation share" definition cannot be circumvented through the issue of shares of a corporation from treasury. For example, a sole shareholder of a small business corporation wishing to sell shares which were acquired from an unrelated person within the 24-month period preceding the expected date of sale could have the corporation issue shares from treasury immediately before the sale. In the absence of the rule in paragraph 110.6(14)(f), the shares issued from treasury could meet the holding period requirement for the purposes of the $500,000 lifetime capital gains exemption.

New subparagraph 110.6(14)(f)(iii) applies to dispositions of shares that occur after June 17, 1987.

Subclauses 56(3) and (4)

ITA
110.6(27) and (28)

Subsections 110.6(27) and (28) of the Act deal with amendments to an election made under subsection 110.6(19) in respect of capital gains accrued to February 22, 1994.

Subject to subsection 110.6(28), subsection 110.6(27) permits an election under 110.6(19) in respect of a property or a business to be amended at any time before 1998 by the filing of an amended election in prescribed form accompanied by payment of an estimate of the penalty in respect of the amended election. This subsection is amended, applicable to the 1994 and subsequent taxation years, to ensure that it only applies for the purposes of section 110.6 other than

subsection 110.6(29) which provides for the calculation of the penalty.

Subsection 110.6(28) of the Act prohibits the revocation or amendment of an election where the amount designated in the election in respect of the property is greater than 11/10 of its fair market value at the end of February 22, 1994. This subsection is amended, applicable to the 1994 and subsequent taxation years, to provide that an election cannot be revoked or amended where the amount designated in respect of a partnership interest or a business exceeds the greater of $1 and the fair market value of the partnership interest or the eligible capital property in respect of the business, as the case may be, at the end of February 22, 1994.

Clause 57

Taxable Dividends Received by Corporations

ITA
112

Section 112 of the Act is one of the principal provisions of the Act dealing with the treatment of dividends received by taxpayers.

Subclause 57(1)

Loss on Share

ITA
112(3) to (3.32)

Subsection 112(3) of the Act contains a "stop-loss" rule which reduces the loss of a corporation from the disposition of a share held as capital property by the amount of tax-free dividends received by the corporation on the share. The provision applies unless the corporation establishes that it held the share for at least 365 days before the disposition, or that the corporation and non-arm’s length persons did not own more than 5% of the shares of any class of the dividend-paying corporation when a tax-free dividend was received by the corporation. Subsections 112(3.1) and (3.2) of the Act provide

similar treatment where the share is held by a partnership or trust. These subsections are amended in several respects.

First, the reference to a "capital dividend" is changed to a reference to a dividend in respect of which an election was made under subsection 83(2) of the Act where the dividend is not a taxable dividend because of subsection 83(2.1) of the Act. Subsection 83(2) permits a private corporation to elect to treat a dividend it pays as a capital dividend. Where the election is made, no part of the dividend is included in the shareholder's income even where the dividend exceeds the corporation's capital dividend account. However, where the conditions in subsection 83(2.1) are satisfied, the capital dividend will be treated as a taxable dividend received by the shareholder and paid by the corporation. Subsection 83(2.1) is an anti-avoidance rule which applies where one of the main purposes of an acquisition of a share is to acquire a right to a capital dividend. Accordingly, under the amended provisions, a dividend subject to subsection 83(2.1) is not treated as a dividend in respect of which an election under subsection 83(2) was made. (For the sake of simplicity in the presentation of these notes describing the amendments to section 112 of the Act, reference to the term "capital dividends" will be maintained.)

Second, the rules are restructured so that the dividends which are excluded from the loss reduction are set out in separate subsections from those which require the loss reduction. The dividends which are excluded are those which meet the 365-day and 5% ownership test and are contained in new subsections 112(3.01), (3.11), (3.31) and (3.32).

Third, the provisions are amended to ensure that only dividends received while the taxpayer and non-arm's length persons held more than 5% of the shares of any class of the dividend-paying corporation are taken into account in reducing a loss from the disposition of a share. Under the existing provisions, a dividend that was received while the taxpayer did not exceed the 5% threshold may have, nevertheless, been taken into account in reducing a loss if another dividend was received at a time when the taxpayer exceeded the 5% threshold.

Fourth, the subsections are amended to ensure that the 365-day holding period can only be met where the taxpayer held the share

throughout the 365-day period that ends immediately before its disposition.

Fifth, as a consequence of the amendment to paragraph 112(6)(a) the provisions are amended to remove the reference to an amount on which a corporation was required to pay tax under Part VII of the *Income Tax Act* chapter 148 of the Revised Statutes of Canada, 1952, as it read on March 31, 1977.

Subsection 112(3) is also amended to expand its application to shares held by a natural person with respect to capital dividends. However, under amended subsection 112(3) a loss will only be reduced by the lesser of:

- the capital dividends received by the person on the share, and

- the amount by which the loss exceeds the taxable dividends received by the person on the share.

This change will ensure that a loss is not reduced to the extent that the loss is attributable to the corporation's payment of taxable dividends to the shareholder.

Subsection 112(3.1) is also amended to expand its application to an individual member of a partnership which receives capital dividends. In a manner akin to the amendment to subsection 112(3), these capital dividends will only reduce an individual's share of a partnership loss where they exceed the individual's share of the loss minus the taxable dividends received by the individual on the share. With respect to members of a partnership that are trusts, the amended provision also applies to taxable dividends and life insurance capital dividends received on a share and designated under subsection 104(19) or (20) of the Act by the trust in respect of a beneficiary that is a corporation, partnership or another trust.

Subsection 112(3.1) is further amended to ensure that a taxpayer's share of a partnership loss is subject to reduction in situations involving multi-tier partnerships. Amended subsection 112(3.1) is intended to reduce an individual or corporate partner's share of a loss from one partnership where the share of a corporation was held by another partnership of which the first partnership has a direct or indirect (that is, through one or more other partnership) interest. Since

the partnerships are flow-through entities with respect to any loss arising from the disposition of a share held by one of the partnerships, the stop-loss rule applies only at the individual or corporate partner level: the loss of a partnership that is a member of another partnership is not reduced under the amended provision.

Subsection 112(3.2), which deals with trust losses other than those addressed under new subsection 112(3.3), is amended to expand its application to taxable dividends and life insurance capital dividends received on a share and designated by a trust to beneficiaries that are corporations, partnerships or other trusts. Under amended paragraph 112(3.2)(a) a trust's loss will also be reduced by the lesser of the following two amounts:

- capital dividends received by the trust, and

- the trust's loss minus certain taxable dividends paid on the share disposed of. (The taxable dividends which count for this purpose are those received and taxed in the trust's hands, designated by the trust in respect of a beneficiary who is a natural person, or designated to other beneficiaries where the trust establishes that the dividends were received on a share that was held for 365 days or more and received when the trust, the beneficiary and persons non-arm's length with the beneficiary owned less than 5% of any class of the capital stock of the corporation.)

Where the trust is an individual's estate and the share was acquired as a consequence of the individual's death, the amount of the loss reduction otherwise determined above will be reduced under subparagraph 112(3.2)(a)(iii) by 1/4 of the lesser of the loss otherwise determined and the capital gain arising from the deemed disposition of the share on the individual's death. In conjunction with subsection 164(6) of the Act, subparagraph 112(3.2)(a)(iii) is intended to enable an individual's estate to ignore, in computing its capital loss in respect of shares of a private corporation, capital dividends up to 1/4 of the deceased's capital gain on the shares, thus promoting integration between the deceased individual and the estate where the deceased's capital gain on the shares is attributable to the appreciation of capital property held by the corporation.

The exclusion for prescribed trusts has been removed in the amended provision, reflecting the fact that no trusts have been prescribed for

the purposes of subsection 112(3.2). In addition, capital losses of mutual fund trusts are not subject to amended subsection 112(3.2).

New subsection 112(3.3) of the Act is a special rule which applies to reduce a trust's loss from the disposition of a share that is considered to have been acquired by the trust because of the application of subsection 104(4) of the Act. At certain times, subsection 104(4) treats property of a trust as having been disposed of and reacquired at its fair market value. Those times are, generally, when the spouse beneficiary of a spousal trust dies and every 21 years thereafter and, in the case of any other trust, every 21 years following the trust's creation. When there is a deemed disposition and reacquisition of shares owned by a trust because of the application of subsection 104(4), the trust is in a similar position to that of an individual's estate: in both cases the capital gain to the trust in respect of a corporation's share may be attributable to the appreciation of capital property held by the corporation, and allowing capital dividends received by the trust after the deemed disposition, of up to 1/4 of the gain triggered by the disposition, to be ignored in computing its loss on a subsequent disposition promotes integration between the corporation and the trust. Therefore, the same provision found in the estate rule in subparagraph 112(3.2)(a)(iii) is set out in subparagraph 112(3.3)(a)(iii).

The new stop-loss rules in subsections 112(3) to (3.32) will generally apply to share dispositions that occur after April 26, 1995. They will not apply, however, to share dispositions taking place after that date where:

1. The shares are owned by a taxpayer on April 26, 1995 and are disposed of pursuant to an agreement in writing made before April 27, 1995.

2. A corporation was a beneficiary of a life insurance policy on the life of a taxpayer on April 26, 1995 and the proceeds of the policy were intended to be used to redeem the shares owned by the taxpayer on April 26, 1995, and the redemption occurs pursuant to an agreement in writing made before 1997. This rule has the following important features:

   – The shares owned by the taxpayer on April 26, 1995 do not have to be shares of the corporation which is the beneficiary of

the life insurance policy; it is only necessary to demonstrate that the proceeds of the policy were intended to be used to acquire the taxpayer's shares. For example, the taxpayer may hold an interest in the corporate beneficiary through one or more holding corporations.

- The shares need not be acquired with the proceeds of the life insurance policy that was in place on April 26, 1995. Therefore, policies may be renewed, converted or entered into after April 26, 1995 without necessarily eliminating the application of these grandfathering rules.

- The life insurance policy may insure the life of the taxpayer or the taxpayer's spouse. This is intended to accommodate joint life insurance policies or other estate planning arrangements.

Similar rules apply where the taxpayer is a spouse trust and the life insured is the beneficiary spouse.

3. The shares are held by a taxpayer on April 26, 1995, a disposition of the shares by the taxpayer's estate before 1997.

4. On April 26, 1995 a taxpayers's estate owns the shares and the estate's first taxation year ends after April 26, 1995, and a disposition of the shares by the estate occurs before 1997.

5. A disposition of shares owned by a spouse trust on April 26, 1995 if the disposition occurs after the death of the beneficiary spouse and before 1997.

A share acquired in exchange for another share on a conversion, corporate reorganization or amalgamation to which section 51, 86 or 87 (respectively) of the Act applies is to be treated as being the same as the exchanged share for the purposes of the above exceptions.

Loss on Share Not Held as Capital Property

ITA
112(4) to (4.22)

Subsection 112(4) of the Act provides a "stop-loss" rule in respect of losses arising with respect to a share that is not held as capital

property. Such losses are reduced by the amount of dividends received by the taxpayer on the share unless the taxpayer owned the share for at least 365 days before the loss was sustained and the taxpayer and non-arm's length persons did not own more than 5% of any class of shares of the dividend-paying corporation at the time a dividend was received.

Subsections 112(4.2) and (4.3) of the Act are similar rules which apply to losses arising from shares held by partnerships and trusts, respectively. Subsection 112(4.1) of the Act is a rule which applies for the purposes of inventory valuation under subsection 10(1) of the Act. Under subsection 112(4.1), a dividend received on a share must be added to the fair market value of the share otherwise determined, unless the taxpayer satisfies the 365-day and 5% share ownership tests described above.

These subsections are amended so that the dividends which are excluded from the amount of loss reduction, because they meet the 365-day and 5% share ownership tests, are set out in new subsections 112(4.01), (4.11), (4.21) and (4.22) of the Act. The 5% ownership tests are also amended to ensure that only dividends received while the taxpayer held more than 5% of the shares of any class of the dividend-paying corporation are taken into account in reducing a loss from a disposition or increasing a fair market value in an inventory valuation. Under the existing provisions, a dividend that was received while the taxpayer and non-arm's length persons did not hold more than 5% of the shares of the dividend-paying corporation may have, nevertheless, been taken into account in reducing a loss or increasing a fair market value if another dividend was received at a time when the taxpayer exceeded the 5% threshold.

The 365-day holding period test is also amended to ensure that it can be met only where the taxpayer held the share throughout the 365-day period ending immediately before the disposition or, in the case where section 10 of the Act applies, at the time of inventory valuation.

The subsections are further amended to remove the references to a capital gains dividend as a consequence of the amendment to paragraph 112(6)(a).

Subsection 112(4) is also amended to expand its application to shares held by a partnership so that any loss reduction is made at the partnership rather than partner level. Accordingly, amended subsection 112(4.2) does not apply to shares held by partnerships.

Subsection 112(4.1) is also amended to expand the purposes for which the provision applies as a consequence of the amendments to section 10 of the Act. New subsection 10(10) of the Act requires a corporation to value its inventory of a business that is an adventure or concern in the nature of trade at the end of the corporation's last taxation year before a change in control. The inventory is valued at the lower of its original cost and its fair market value. Amended subsection 112(4.1) applies for the purposes of determining the fair market value of such inventory.

Lastly, the exclusion for a prescribed trust in these subsections has been removed because no trusts have been prescribed for the purpose of these provisions.

Amended subsections 112(4) and (4.2) and new subsections 112(4.01), (4.21) and (4.22) apply to dispositions that occur after April 26, 1995. Amended subsection 112(4.1) and new subsection 112(4.11) apply to taxation years that end after April 26, 1995.

Subclauses 57(2) to (5)

Adjustment to Proceeds of Disposition

ITA
112(5.1)(b) and (5.2)

Subsections 112(5) and (5.1) of the Act set out the criteria for determining when the stop-loss rule in subsection 112(5.2) of the Act applies. Subsection 112(5.2) applies to adjust a taxpayer's proceeds of disposition arising from the disposition of a share in certain circumstances. In general terms, subsection 112(5.2) prevents a taxpayer from obtaining a deduction for the part of a taxpayer's overall loss in respect of a share to the extent that the taxpayer has received dividends on the share.

Subsection 112(5) provides that subsection 112(5.2) applies where a financial institution disposes of a share that is a mark-to-market property and the financial institution and non-arm's length persons held more that 5% of any class of the corporation on which the dividends were paid.

Subsection 112(5.1) provides that subsection 112(5.2) applies where a taxpayer disposes of a share that is held for less than 365 days if the disposition was an actual disposition and the share was a mark-to-market property for any taxation year beginning after October 1994 in which the taxpayer was a financial institution. The 365-day holding period in paragraph 112(5.1)(b) is amended so that the taxpayer must hold the share throughout the 365-day period ending immediately before the disposition. This amendment is consistent with the 365-day tests in amended subsections 112(3.01) to (4.22) of the Act.

Paragraph (b) of the description of B in subsection 112(5.2) is amended to remove the reference to capital gains dividends as a consequence of the amendment to paragraph 112(6)(a).

New subsection 112(5.21) is added to the Act to ensure that only dividends received while the taxpayer and non-arm's length persons held more than 5% of the issued shares of any class of the dividend-paying corporation are included in the total determined under paragraph (b) of the description of B in subsection 112(5.2). Under existing subsections 112(5.1) and (5.2), a dividend that was received while the taxpayer and non-arm's length persons did not hold more than 5% of the shares of the dividend-paying corporation may have, nevertheless, been taken into account in reducing a loss if another dividend was received at a time when the taxpayer exceeded the 5% threshold. New subsection 112(5.21) also maintains the application of the 365-day holding period contained in subsection 112(5.1).

A consequential amendment is made to paragraph (b) of the description of C in subsection 112(5.2) to replace the reference to subsection 112(4.3) of the Act with a reference to subsection 112(4.2) of the Act.

These amendments apply to dispositions that occur after April 26, 1995.

Subclause 57(6)

ITA
112(5.5)

Subsection 112(5.5) of the Act provides that the stop-loss rules in subsections 112(3) to (4), (4.2) and (4.3) of the Act are not applicable in specified circumstances. The subsection is amended by removing the reference to subsection 112(4.3) of the Act which is being repealed by this Act.

Subclause 57(7)

Stop-Loss Rules Restricted

ITA
112(5.6)

In the case of certain dispositions, subsection 112(5.6) of the Act provides that the holding of a share for less than 365 days does not cause the existing stop-loss rules in subsections 112(3) to (4), (4.2) and (4.3) of the Act to apply. Therefore, those rules will have potential application only where dividends are received on a share of a corporation of which the shareholder and non-arm's length persons own more than 5% of any class of shares. The amendment to subsection 112(5.6) is consequential on the amendments to those stop-loss rules and merely changes the references to the provisions in which the 365-day share ownership tests are found.

Amended subsection 112(5.6) applies to dispositions that occur after April 26, 1995.

Subclause 57(8)

Meaning of Certain Expressions

ITA
112(6)(a)

For the purposes of section 112 of the Act, paragraph 112(6)(a) states that the term "taxable dividend" is not to include a capital gains dividend as defined by subsection 131(1) of the Act.

Paragraph 112(6)(a) is amended to exclude a capital gains dividend and a dividend received by a taxpayer on which the taxpayer was required to pay tax under Part VII of the Act, as it read on March 31, 1977, from the meaning of "taxable dividend" and "dividend". Part VII of the Act levied a tax of 25% on certain taxable dividends received by either a corporation resident in Canada or an unincorporated trader or dealer in securities. The tax was equal to 25% of the portion of the taxable dividend paid out of the designated surplus of the payer corporation. The stop-loss rules in subsections 112(3) to (4.3) and (5.2) of the Act do not apply to capital gains dividends or dividends subject to the former Part VII tax. Since the amended stop-loss rules in section 112 do not contain references to these dividends, the dividends will be excluded by amended paragraph 112(6)(a).

Amended paragraph 112(6)(a) applies after April 26, 1995.

Subclause 57(9)

Rules Where Shares Exchanged

ITA
112(7)

Subsection 112(7) of the Act provides rules relating to the application of the "stop-loss" rules in subsections 112(3) to (3.2) of the Act to shares that have been acquired in exchange for other shares (the "old shares") on a conversion, share-for-share exchange, corporate reorganization or amalgamation. Existing subsection 112(7) provides that the loss otherwise determined on the disposition of a new share acquired in such an exchange is reduced by the taxable dividends, capital dividends and life insurance capital dividends received on the new share which are subject to the stop-loss rules in subsection 112(3), (3.1) or (3.2) as well as the same types of dividends received on all the old shares that are attributed to the new share. Where the number of old shares and new shares exchanged is not equal, the dividends received on the old shares are attributed to the new share on a pro rata basis using the adjusted cost bases of the new shares immediately after the exchange. The dividends received on an old share that are attributed to a new share are limited to the adjusted cost base of the old share. Existing subsection 112(7) does not make it clear that a loss from the disposition of a new share

should only be reduced by the dividends received on the old shares which do not meet the 365 day and 5% share ownership tests in subsections 112(3) to (3.2).

Amended subsection 112(7) applies for the purposes of the amended stop-loss rules in subsections 112(3) to (3.32). Rather than adjusting the amount of loss otherwise determined on a disposition of a new share, amended subsection 112(7) treats an old share as being the same as the new share acquired in exchange for the old share and treats the dividends received on the old share as having been received on the new share. Under amended paragraph 112(7)(a), any dividends received on the old share are considered to have been received on the new share in the proportion that the adjusted cost base of the new share is of the total adjusted cost bases of all the new shares acquired in exchange for that old share. Thus, if the amended stop-loss rules apply to reduce a loss from the disposition of a new share, only the appropriate dividends received on the old shares will be taken into account. Under amended paragraph 112(7)(b) the amount of loss that can be reduced on a disposition of a new share, due to the dividends that are attributed to the new share because of paragraph 112(7)(a), is limited to the adjusted cost base of the old share acquired in exchange for the new share.

This amendment applies to dispositions that occur after April 26, 1995.

Clause 58

Taxable Income Earned in Canada by Non-Residents

ITA
115

Section 115 of the Act provides rules for calculating a non-resident's taxable income earned in Canada.

Subclauses 58(1) and (2)

ITA
115(1)(b), 115(3)

Paragraph 115(1)(b) of the Act lists the types of property (called "taxable Canadian property") in respect of which taxable capital gains and allowable capital losses figure in the calculation of a non-resident's taxable income earned in Canada. In addition to renumbering its subparagraphs and updating its language, this paragraph is revised in several respects.

First, subparagraph 115(1)(b)(ii) of the Act is modified to clarify that a non-resident's ships and aircraft used principally in international traffic, as well as related personal property, are not taxable Canadian property, provided the country in which the non-resident is resident grants substantially similar relief to persons resident in Canada.

Second, paragraph 115(1)(b) is amended to modify the basic criterion for determining whether a share of the capital stock of a corporation is taxable Canadian property, replacing a test based on the status of the corporation as a public corporation with a test based on whether or not the share is listed on a prescribed Canadian or foreign stock exchange. Revised subparagraph 115(1)(b)(iv) provides that an unlisted share of a corporation resident in Canada (other than a mutual fund corporation) is taxable Canadian property. Under revised subparagraph 115(1)(b)(vi), a listed share of a Canadian-resident corporation, or a share of a mutual fund corporation, is taxable Canadian property if the shareholder, together with all non-arm's length persons, owned 25% or more of the shares of any class of the corporation's stock at any time in the preceding five years.

Third, amended subparagraph 115(1)(b)(v) treats certain unlisted shares of non-resident corporations as taxable Canadian property. Such a share will be taxable Canadian property at a particular time if two criteria are both met. First, at some time in the 12 months preceding the particular time more than half of the fair market value of the corporation's property must be in the form of taxable Canadian property, Canadian resource properties, timber resource properties, income interests in Canadian-resident trusts or interests in or options in respect of these sorts of property. Second, at the same time more than half of the fair market value of the share itself must be derived

directly or indirectly from any one or more real properties in Canada, Canadian resource properties or timber resource properties.

A share of a non-resident corporation that meets the tests described above will usually not be taxable Canadian property if it is listed on a prescribed stock exchange. If the shareholder has held 25% or more of the shares of any class of the
corporation's stock at any time in the preceding five years, however, subparagraph 115(1)(b)(vi) provides that the share is taxable Canadian property even if it is listed on a prescribed exchange.

A fourth change to paragraph 115(1)(b) treats as taxable Canadian property certain interests in non-resident trusts. The tests for this treatment, set out in subparagraph 115(1)(b)(ix), are comparable to those that apply to shares of non-resident corporations.

Another change slightly modifies the description of those partnership interests that are taxable Canadian property. Under existing paragraph 115(1)(b)(v), a partnership interest is taxable Canadian property if, at any time in the 12 months before the interest is disposed of, 50% or more of the value of the partnership's property was represented by taxable Canadian property, Canadian resource property, timber resource property and income interests in Canadian resident trusts. New subparagraph (vii) changes the applicable percentage from 50% or more to over 50%, the same number as in new subparagraphs (v) and (xi). The new subparagraph also clarifies that options in respect of the various sorts of property it describes are treated for this purpose in the same way as the property itself.

Lastly, a rule is added to paragraph 115(1)(b) which was formerly a separate subsection. New subparagraph 115(1)(b)(xiii) treats interests in an options in respect of taxable Canadian property as being themselves taxable Canadian property. Since this replicates the effect of subsection 115(3), that subsection is repealed.

Amended paragraph 115(1)(b) and the repeal of subsection 115(3) apply after April 26, 1995, with certain exceptions. The amendments do not apply to a disposition of property before 1996 to a person who was obliged to acquire the property under an agreement in writing made on or before April 26, 1995. (For this purpose a person is not considered to be obliged to acquire property where the obligation can be relieved if there is a change to the Act or an adverse assessment

under the Act.) The amendments also do not apply to a disposition before 1996 pursuant to a prospectus or similar document filed with the relevant securities authority before April 27, 1995. And where a property (such as a share of a non-resident corporation, or an unlisted share of a public corporation) has become taxable Canadian property as a result of these amendments, new subsection 40(9) of the Act may reduce a taxpayer's gain or loss on a disposition of the property. For more information on new subsection 40(9), reference should be made to the notes to that provision.

Clause 59

Dispositions of Property by Non-Residents

ITA
116

Section 116 of the Act sets out information reporting and tax collection procedures relating to non-residents' dispositions of taxable Canadian property.

Subclause 59(1)

ITA
116(1)

Subsections 116(1) and (2) of the Act allow a non-resident who plans to dispose of taxable Canadian property to obtain what is commonly known as a "clearance certificate" in respect of the disposition. Subsection 116(1) is amended, with application after April 26, 1995, to clarify that it does not apply to dispositions to which subsection 116(5.2) of the Act applies.

Subclause 59(2)

ITA
116(3)

Subsection 116(3) of the Act requires a non-resident who disposes of taxable Canadian property to provide certain information to the Minister of National Revenue. This provision is amended, with

application after April 26, 1995, to clarify that it does not apply to dispositions to which subsection 116(5.2) of the Act applies.

Subclause 59(3)

ITA
116(5.2)

Subsection 116(5.2) of the Act provides for "clearance certificates" in respect of dispositions by non-residents of certain sorts of property. The subsection is amended to provide that it does not apply in respect of the disposition of "excluded property," defined for this purpose in subsection 116(6) of the Act. The amendment, which applies to dispositions that occur after 1996, also clarifies that subsection 116(5.2) applies to the disposition of any interest in, or option in respect of, a property to which the subsection applies.

Subclause 59(4)

ITA
116(6)(b)

The various rules in section 116 of the Act, which provides a withholding procedure for the purchaser of certain property, do not apply where the property is what is defined in subsection 116(6) of the Act as "excluded property".

Under subparagraphs 115(1)(b)(iii) and (iv) of the Act, a share of a public corporation is taxable Canadian property only if the person disposing of the share (along with persons with whom that person did not deal at arm’s length) held a significant interest in the corporation. Since the purchaser of a publicly-traded share will ordinarily not know who the vendor of the share is, let alone the extent of the vendor’s interest in the corporation, paragraph 116(6)(b) currently treats a share of the capital stock of a public corporation, or an interest in such a share, as excluded property.

With the amendment of paragraph 115(1)(b), the focus of determining if a share of a corporation resident in Canada is taxable Canadian property under that provision has shifted from whether or not the corporation is a public corporation to whether or not the class of shares in question is listed on a prescribed stock exchange. This

amendment to paragraph 116(6)(b) imports the same test into the definition of excluded property. Under amended paragraph 116(6)(b), a share of a class of a corporation's stock, or an interest in a share, will be excluded property if that class is listed on any prescribed exchange. The amendment applies after April 26, 1995, except in respect of certain dispositions before 1996. The excluded dispositions are the same as those to which the amendments to paragraph 115(1)(b) do not apply; for more information, readers should consult the notes to that provision.

Clause 60

Age Tax Credit

ITA
118(2)

Subsection 118(2) of the Act provides an age tax credit for individuals who are over 65 years of age or who reach age 65 in the year. The credit is calculated as a percentage (17 per cent for 1994) of an indexed base amount ($3,482 for 1994). The base amount upon which an individual's age tax credit is calculated is reduced by 15 per cent of the amount by which the individual's income for the year exceeds $25,921. For 1994, the reduction is only one-half of the reduction otherwise determined.

Section 79 of the Act provides special rules where a creditor acquires or reacquires a property in consequence of a debtor's failure to pay any part of a mortgage or other debt. The capital gain arising from such a transaction is included in the income base upon which the reduction in the age tax credit is calculated, resulting in certain circumstances in a reduced credit.

Subsection 118(2) is amended, applicable to 1994 and subsequent taxation years, to exclude a capital gain arising by virtue of section 79 of the Act from the income base upon which the reduction in the age tax credit is calculated.

Clause 61

Disability Tax Credit

ITA
118.4(2)

Section 118.4 of the Act sets out the circumstances under which an individual will be considered to have a severe and prolonged impairment, in order to determine whether the individual may be eligible for the disability tax credit. Subsection 118.4(2) provides a definition of the group of people to whom various references in section 63 (relating to child care expenses), section 118.2 (relating to medical expenses) and section 118.3 (relating to the disability tax credit) of the Act apply.

When the Statute Revision Commission revised the Act in the Fifth Supplement of the Revised Statutes of Canada, 1985, the term "medical doctor" was erroneously omitted from the list of people included in subsection 118.4(2). This amendment restores that reference. The amendment applies to taxation years that end after November 1991, as these are the taxation years to which the amendment which deleted the reference applied.

Clause 62

Tuition Tax Credit

ITA
118.5(1)

Subsection 118.5(1) of the Act provides a tax credit in respect of tuition fees paid to certain educational institutions. New subparagraph 118.5(1)(a)(v) is added to ensure that where, under a federal program designed to assist athletes, tuition fees are paid on behalf of an individual or the individual is entitled to a reimbursement, the individual will not be entitled to claim a tuition tax credit unless the payment or reimbursement is included in computing income.

New subparagraph 118.5(1)(a)(v) applies to 1994 and subsequent taxation years.

Clause 63

Credits in Year of Bankruptcy

ITA
118.95

Where an individual becomes bankrupt, subsection 128(2) of the Act divides the calendar year in which the bankruptcy occurs into two taxation years: one that runs from January 1 to the day before the bankruptcy (the pre-bankruptcy period) and the other that begins on the day of the bankruptcy and runs to December 31 (the post-bankruptcy period). Under the current provisions governing non-refundable tax credits in sections 118 to 119 of the Act, an individual may claim full credits in respect of each of these periods, even though this means that the individual may get the benefit of these credits twice in respect of the same calendar year.

New section 118.95 is added to the Act to ensure that, where an individual becomes bankrupt in a calendar year, these non-refundable tax credits in respect of each of the two periods in the calendar year will generally be calculated on a pro-rata basis (except for those credits that are based on expenditures or the receipt of certain types of income during the period). The calculation of credits will be similar to the calculation of credits in respect of individuals residing in Canada for only part of a taxation year, which is contained in section 118.91 of the Act. The personal tax credits, the age tax credit, the disability tax credit and the transfers of unused credits will be subject to pro-ration based on the number of days in the period for which the return is filed. The pension tax credit, charitable donations tax credit, medical tax credit and the tuition and education tax credits will be based on the related amounts in respect of each period. In all cases, the total of the amounts claimed in respect of each of these credits for both the pre and post-bankruptcy periods cannot be greater than the amount that could be claimed in respect of the calendar year. New section 118.95 applies to bankruptcies that occur after April 26, 1995.

Clause 64

Minimum Tax Carry-Over

ITA
120.2(4)(a)

Section 120.2 of the Act provides for the carry-over of additional taxes paid under the minimum tax provisions for previous taxation years.

Where an individual becomes bankrupt, the trustee in bankruptcy for the individual is required under paragraph 128(2)(e) of the Act to file income tax returns on behalf of the individual in respect of income arising from the individual's estate and business. Currently, the trustee cannot utilize any minimum tax carry-over of the individual in such a return in computing the tax payable by the individual.

Paragraph 120.2(4)(a) of the Act is amended to provide that, for taxation years that begin after April 26, 1995, the trustee may claim under subsection 120.2(1) of the Act any available minimum tax carry-over in an income tax return that is required under paragraph 128(2)(e). However, the individual, who is required to file an income tax return under paragraph 128(2)(f), may not deduct any such amount under that subsection for such years.

Clause 65

Child Tax Credit

ITA
122.2

Before its repeal and replacement by the child tax benefit for 1993 and subsequent years, section 122.2 of the Act provided the rules for determining the child tax credit for individuals. A taxpayer's total child tax credit in respect of a year was reduced by five cents for each dollar of the individual's family income in excess of an indexed threshold. For this purpose, the individual's family income for the

year was the total of the incomes for the year of the taxpayer and a supporting person.

Section 79 of the Act provides special rules where a creditor acquires or reacquires a property in consequence of a debtor's failure to pay any part of a mortgage or other debt. The capital gain arising from such a transaction is included in the income base upon which both the child tax credit and the child tax benefit are calculated, resulting in certain circumstances in a reduced credit.

Section 122.2 is amended, in its application to the 1992 taxation year, to exclude a capital gain arising by virtue of section 79 of the Act from the income base of the child tax credit. Similar amendments are also being made to the child tax benefit.

Clause 66

Goods and Services Tax Credit

ITA
122.5

Section 122.5 of the Act provides the rules for determining the Goods and Services Tax (GST) credit for individuals.

Subclause 66(1)

ITA
122.5(1)

"adjusted income"

A taxpayer's total GST credit in respect of a year is reduced by five cents for each dollar of the taxpayer's adjusted income in excess of an indexed threshold. For this purpose, a taxpayer's "adjusted income" for a year, which is defined in subsection 122.5(1) of the Act, is the total of the incomes for the year of the taxpayer and the taxpayer's cohabiting spouse and the end of that year.

Section 79 of the Act provides special rules where a creditor acquires or reacquires property in consequence of a debtor's failure to pay any

part of a mortgage or other debt. The capital gain arising from such a transaction is included in the income base upon which the GST tax credit is calculated, resulting in certain circumstances in a reduced credit.

Section 122.5 is amended, applicable to the 1992 and subsequent taxation years, to exclude a capital gain arising by virtue of section 79 of the Act from the income base upon which the GST credit is calculated.

Subclause 66(2)

ITA
122.5(1)

"eligible individual"

An "eligible individual", for purposes of the GST credit, is defined as an individual who is resident in Canada at the end of December and who is married, a parent or at least 19 years old at that time. This amendment to the definition, which is consequential on the addition of new subsection 122.5(7) to the Act, clarifies that an individual must be resident in Canada at the end of December 31 of a year. This amendment applies after April 26, 1995.

Subclause 66(3)

ITA
122.5(7)

Where an individual becomes bankrupt, subsection 128(2) of the Act divides the calendar year in which the bankruptcy occurs into two taxation years: one that runs from January 1 to the day before the bankruptcy (the pre-bankruptcy period) and the other that begins on the day of the bankruptcy and runs to December 31 (the post-bankruptcy period). Under the current provisions governing the GST credit, only the income from the post-bankruptcy period is taken into account in future periods for the purposes of determining the "adjusted income" upon which the GST credit is based.
New subsection 122.5(7) is added to the Act to ensure that, where an individual becomes bankrupt in a calendar year, the individual's entitlement to the GST credit in subsequent years will be calculated

based on income from both the pre and post-bankruptcy periods. By virtue of the wording of this new subsection and the definition "adjusted income" in subsection 122.5(1), where a spouse become bankrupt, the spouse's income from both periods will also be taken into consideration.

New subsection 122.5(7) applies to bankruptcies that occur after April 26, 1995.

Clause 67

Child Tax Benefit - Definitions

ITA
122.6

Section 122.6 of the Act contains definitions for the purposes of the child tax benefit (CTB). This benefit is delivered in non-taxable monthly payments based on family earnings, income, number of children and child care expenses.

Subclause 67(1)

ITA
122.6

"adjusted income"

The amount of the monthly CTB is based on a taxpayer's "adjusted income", which is the total of the incomes for a base taxation year of the taxpayer and the taxpayer's cohabiting spouse at the end of that year. For the first 6 months of a year, the base taxation year is the second preceding year, and, for the last 6 months of a year, the base taxation year is the preceding year.

Section 79 of the Act provides special rules where a creditor acquires or reacquires a property in consequence of a debtor's failure to pay any part of a mortgage or other debt. The capital gain arising from such a transaction is included in the income base upon which the CTB is calculated, resulting in certain circumstances in a reduced benefit payable in a subsequent year.

The definition "adjusted income" in section 122.6 is amended to exclude a capital gain arising by virtue of section 79 from the income base upon which the CTB is calculated. This amendment is effective with respect to child tax benefit payments arising after June 30, 1993.

Subclause 67(2)

ITA
122.6

"eligible individual"

Paragraphs (g) and (h) of the definition "eligible individual" refer to regulations made by the Governor in Council on the recommendation of the Minister of National Health and Welfare. These paragraphs are amended to replace these references with references to prescribed circumstances and prescribed factors. This amendment, which applies after August 27, 1995, reflects the shift in responsibility from the Minister of National Health and Welfare to the Minister of National Revenue.

Clause 68

Child Tax Benefit - Bankrupt Individuals

ITA
122.61(3.1)

Where an individual becomes bankrupt, subsection 128(2) of the Act divides the calendar year in which the bankruptcy occurs into two taxation years: one that runs from January 1 to the day before the bankruptcy (the pre-bankruptcy period) and the other that begins on the day of the bankruptcy and runs to December 31 (the post-bankruptcy period). Under the current provisions governing the child tax benefit (CTB), only the income from the post-bankruptcy period is taken into account in future periods for the purposes of determining the income upon which the CTB is based and the earned income upon which the earned income supplement to the CTB is based.

New subsection 122.6(3.1) is added to the Act to ensure that, where an individual becomes bankrupt in a calendar year, the individual's entitlement to the CTB and the earned income supplement in subsequent years will be calculated based on income from both the pre and post-bankruptcy periods. By virtue of the wording of this new subsection and the definitions "adjusted income" and "adjusted earned income" in section 122.6, where a spouse become bankrupt, the spouse's income from both periods will also be taken into consideration.

New subsection 122.6(3.1) applies to bankruptcies that occur after April 26, 1995.

Clause 69

Child Tax Benefit - Eligible Individuals

ITA
122.62

Section 122.62 of the Act deals with various situations in which a person becomes or ceases to become an eligible individual or a cohabiting spouse of such an individual for purposes of the child tax benefit (CTB).

Subclause 69(1)

ITA
122.62(1) and (2)

Subsection 122.62(1) of the Act provides that, as a general rule, a person will be entitled to a CTB for a particular month only if the person files the required notice with the Minister of National Health and Welfare before the end of the eleventh month following that month. However, subsection 122.62(2) provides that the Minister may extend the period to file the notice. These subsections are amended, applicable after August 27, 1995, to require the filing of the notice in prescribed form containing prescribed information with the Minister of National Revenue and to give to this Minister the power to extend the period for filing the notice.

Subclause 69(2)

ITA
122.62(4)

Subsection 122.62(4) of the Act requires a person who ceases to be an eligible individual in respect of a qualified dependant to inform the Minister of National Health and Welfare of that fact before the end of the following month. This subsection is amended to require the person to notify the Minister of National Revenue. The notification need not necessarily be in writing.

This amendment applies after August 27, 1995.

ITA
122.62(5) to (9)

Subsection 122.62(5) of the Act enables the Minister of National Health and Welfare to waive the requirement to file a notice under subsection 122.62(1) or the requirement under subsection 122.62(4) to inform the Minister upon ceasing to be an eligible individual in respect of a qualified dependant. Paragraph 122.62(5)(a), which deals with the filing of notices, is deleted as the Minister of National Revenue already has the power, under subsection 220(2.1) of the Act, to waive the requirement to file a notice. Paragraph 122.62(5)(b), which deals with notification when ceasing to be an eligible individual, is also deleted as a result of the amendment to subsection 122.62(4) of the Act. Since the requirement to inform the Minister in writing when a person ceases to be an eligible individual has been removed, there is no need to have a provision to waive the requirement to inform the Minister.

Subsections 122.62(6) to (8) of the Act deal with elections filed with the Minister of National Health and Welfare upon the death of a cohabiting spouse or when a person separates from or becomes a cohabiting spouse. The subsections are amended in order that the elections be filed with the Minister of National Revenue. Subsections 122.62(6) to (8) have been renumbered as 122.62(5) to (7) to reflect the fact that old subsection 122.62(5) is no longer required. Previous subsection (9), which dealt with obtaining advice from the Minister of National Health and Welfare, is deleted as the

Minister of National Revenue will be responsible for the child tax benefit program.

These amendments apply after August 27, 1995.

Clause 70

Child Tax Benefit - Agreements

ITA
122.63

Section 122.63 deals with agreements between the federal government and provinces regarding the basic amount of the child tax benefit. The reference to the Minister of National Health and Welfare has been deleted, applicable after August 27, 1995, as that department will no longer have responsibility in respect of the child tax benefit program.

Clause 71

Child Tax Benefit - Communication of Information

ITA
122.64

Section 122.64 of the Act deals with the treatment of information obtained for the purposes of the child tax benefit.
Subsection 122.64(2) allows information obtained under the child tax benefit provisions or the *Family Allowances Act* to be provided to an official of the Department of National Health and Welfare for the purposes of certain stated acts.

Subsection 122.64(2) is amended to remove the reference to the *Children's Special Allowances Act* since the Minister of National Health and Welfare will no longer be responsible for the administration of that Act, and to add a reference to the *Family Allowances Act* to permit the disclosure of information obtained under that Act to the Minister of National Health and Welfare for the purpose of the administration of that Act. This provision is necessary

since subsection 122.64(1) deems the information obtained under the *Family Allowances Act* to be obtained by the Minister of National Revenue, so that such information is protected under the confidentiality provisions of section 241 of the *Income Tax Act.*

Subsection 122.64(2) is also amended to incorporate the wording from subsection 122.64(5) of the Act, which defines official as being within the meaning assigned by subsection 241(10) of the Act. As a consequence, subsection 122.64(5) of the Act is repealed.

These amendments apply after August 27, 1995.

Clause 72

Small Business Deduction

ITA
125

Section 125 of the Act provides a corporate tax reduction (called the "small business deduction") in respect of income of a Canadian-controlled private corporation (CCPC) from an active business carried on in Canada.

Subclause 72(1)

ITA
125(1)

Subsection 125(1) of the Act provides the basic rules for the calculation of a CCPC's small business deduction. The small business deduction is provided by way of an annual tax credit which is calculated as 16 per cent of the least of:

- a corporation's active business income for a taxation year;
- its taxable income for the year; and
- its business limit for the year (which is generally $200,000).

The small business deduction is intended to apply only to corporations that are CCPCs throughout the taxation year for which they are claiming the deduction. The amendment to subsection 125(1) of the Act simply corrects an error which occurred at the time subsection 125(1) was last amended (1988), thereby ensuring that this intention prevails. It is generally applicable to taxation years that end after June 1988.

Subclause 72(2)

ITA
125(7)

"Canadian-controlled private corporation"

Subsection 125(7) of the Act defines "Canadian-controlled private corporation", among other terms. This definition applies not only to the small business deduction under section 125 but also, through its incorporation by reference into subsection 248(1) of the Act, to the Act as a whole.

Currently, a corporation is a CCPC if it is a private corporation and a Canadian corporation (both of which terms are defined in subsection 89(1) of the Act), and it is not controlled, directly or indirectly in any manner whatever by one or any combination of public corporations (other than prescribed venture capital corporations) or non-resident persons. This amendment ensures that two other types of corporation are not CCPCs. The first type are corporations that, if they are not actually controlled by non-residents, avoid that status only because their shares are widely held. The second type are corporations the shares of which are listed on a foreign stock exchange. The following paragraphs describe in more detail how the amended definition applies to each of these cases.

A corporation the voting shares of which are distributed among a large number of persons is usually not considered to be controlled by any group of its shareholders, provided the shareholders do not act together to exercise control. As a result, it may be argued that a private Canadian corporation that is owned by a number of non-residents or public corporations is not controlled by non-residents or public corporations, and is thus a CCPC. New paragraph (b) of the CCPC definition clarifies that this is not the case. Paragraph (b)

requires non-residents’ and public corporations’ shareholdings – not only of the corporation in question, but of all corporations – to be notionally attributed to one hypothetical person. If that person would control the corporation, then the corporation is not a CCPC.

Under the definition of "public corporation" in subsection 89(1) of the Act, a corporation the shares of which are listed on a prescribed Canadian exchange will usually be a public corporation, and thus not a CCPC. New paragraph (c) of the CCPC definition extends similar treatment to corporations the shares of which are traded on foreign exchanges. Specifically, the paragraph provides that a corporation is not a CCPC if any of its shares are listed on any prescribed stock exchange (that is, either a Canadian exchange listed in Income Tax Regulation 3200 or a foreign exchange listed in Regulation 3201).

This amendment applies after 1995.

Subclause 72(3)

ITA
125(7)

"specified investment business"

A "specified investment business" carried on by a corporation is defined in subsection 125(7) of the Act in general terms as a business the principal purpose of which is to derive income from property and which does not employ more than five full-time employees.

Income from a "specified investment business" does not qualify for the small business deduction under section 125. However, such income from Canadian sources is considered to be "Canadian investment income" under subsection 129(4.1) of the Act. The rules in section 129 allow for a tax refund for a corporation of up to 20% of Canadian investment income on the payment of dividends by the corporation.

The definition "specified investment business" is amended, applicable to the 1995 and subsequent taxation years, to include a business carried on by a prescribed labour-sponsored venture capital corporation where the main purpose of the business is to derive income from property. This measure applies irrespective of the

number of the employees of the corporation or of any corporation associated with it.

Section 6701 of the *Income Tax Regulations*, which provides the meaning of "prescribed labour-sponsored venture capital corporation" for a number of provisions of the Act, will be amended to apply for the purpose of the definition "specified investment business" in subsection 125(7).

Clause 73

Refundable Investment Tax Credits

ITA
127.1(1)

Subsection 127.1(1) of the Act allows a taxpayer to claim a refundable investment tax credit for a taxation year.

Subclause 73(1)

ITA
127.1(1)(a)

At present, a trustee in bankruptcy required to file an income tax return under paragraph 128(2)(e) of the Act may not claim a refundable investment tax credit under subsection 127.1(1). Paragraph 127.1(1)(a) is amended to add a reference to paragraph 128(2)(f) of the Act and to delete the reference to paragraph 128(2)(e) of the Act. Accordingly, for taxation years that begin after April 26, 1995, an individual who is bankrupt during a taxation year and who is required to file an income tax return under 128(2)(f) may not claim a refundable investment tax credit under subsection 127.1(1). The trustee in bankruptcy for the individual may, however, make such a claim for those years.

Subclause 73(2)

ITA
127.1(1)

Subsection 127.1(1) of the Act provides that a taxpayer's refundable investment tax credit, 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. This amendment to subsection 127.1(1) provides that the payment will be deemed to have been made on the day that the taxpayer is required to pay the balance of the 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.

Clause 74

Part XII Tax Credit

ITA
127.41(1)(a)

Section 127.41 of the Act provides a refundable tax credit to beneficiaries of a mining reclamation trust, recognizing that trust income is subject to a tax under Part XII.4 of the Act and is also allocated to one or more beneficiaries income under subsection 107.3(1). The amount of the tax credit is, under paragraph 127.41(1)(a), normally based on a beneficiary's pro-rata share of Part XII.4 tax. However, where a beneficiary of a mining reclamation trust is a partnership, under paragraph 127.41(1)(b) members of the partnership are allowed a tax credit equal to a pro-rata share of the Part XII.4 tax credit to which the partnership would be entitled if it were a person.

Paragraph 127.41(1)(a) is amended so that partnership losses are, for the purposes of calculating the component of the tax credit under paragraph 127.41(1)(a), treated in a parallel fashion to partnership income. Consequently, neither partnership income nor partnership losses have any bearing on the calculation of the portion of the tax

credit determined under paragraph 127.41(1)(a). The amendment is of relevance only in cases where a taxpayer is a direct beneficiary in one mining reclamation trust and an indirect beneficiary (through a partnership) in another mining reclamation trust.

This amendment applies to taxation years that end after February 22, 1994.

Clause 75

Minimum Tax

ITA
127.5

Section 127.5 of the Act levies the minimum tax payable by an individual under Part I for a taxation year.

Section 127.5 is amended as a consequence of the enactment of new paragraph 127.55(f). For additional details see the commentary on that paragraph.

This amendment applies to the 1992 and subsequent taxation years.

Clause 76

Minimum Tax - Adjusted Taxable Income

ITA
127.52

Section 127.52 of the Act defines the "adjusted taxable income" of an individual for a taxation year for the purposes of determining any minimum tax liability under Division E.1 of Part I of the Act.

Subclauses 76(1) to (5)

ITA
127.52(1)

Subsection 127.52(1) of the Act defines the "adjusted taxable income" of an individual for a taxation year as the amount that would be the individual's taxable income for that year if the assumptions set out in paragraphs 127.52(1)(a) to (j) were made. A number of amendments are being made to this subsection.

First, subsection 127.52(1) is amended to extend its application to:

- certain losses deducted by a limited partner, a member of a partnership who has been a specified member since becoming a partner, or a partner for whose interest an identification number is required to be, or has been, obtained under section 237.1. For this purpose, losses allocated from a partnership are netted against gains from the same partnership source – that is allowable capital losses of the partnership against taxable capital gains of the partnership; business losses of the partnership against taxable capital gains of the partnership arising from the disposition of property used in the business; and property losses of the partnership against taxable capital gains of the partnership arising from the disposition of property held to earn income from property;

- losses deducted in respect of investments identified or required to be identified under the tax shelter identification rules; and

- carrying charges in respect of investments described above as well as those described in paragraphs 127.52(1)(b), (c) and (e), which relate to deductible amounts in respect of rental/leasing property, film property and resource-related deductions.

These amendments apply to taxation years of an individual that begin after 1994.

Subsection 127.52(1) is also amended, applicable to the 1994 and 1995 taxation years, by adding new paragraph 127.52(1)(h.1). This paragraph is consequential on the addition of paragraph 110.6(21)(a) to the Act. It ensures that the portion of the gain from the deemed

disposition of non-qualifying real property under subsection 110.6(19) that is not eligible for the capital gains exemption will be excluded from the adjusted taxable income computation in subsection 127.52(1). Subsection 110.6(21) ensures that the tax on that portion of the gain that is not so eligible is deferred until a subsequent taxable disposition. Similarly, on such a subsequent disposition that gain will be included in the adjusted taxable income computation.

Paragraph 127.52(1)(i) provides rules that apply to an individual's losses arising in another taxation year that are relevant in the year in which the individual is computing "adjusted taxable income" for minimum tax purposes. Paragraph 127.52(1)(i) is amended to ensure that such losses from another taxation year are computed on the basis of the wording of subsection 127.52(1) as it reads for that year. These amendments generally apply to taxation years of an individual that begin after 1994, except that the amendment of paragraph 127.52(l)(i) of the Act applies after December 1, 1994 to any taxation year.

Clause 127.52(1)(i)(ii)(B) is also amended to include the full amount of net capital losses incurred before 1986 in the calculation of an individual's adjusted taxable income. This amendment generally applies in determining an individual's adjusted taxable income for taxation years that begin after 1994.

Subclause 76(6)

ITA
127.52(2)

Subsection 127.52(2) of the Act provides a special rule that applies where an individual has invested in a partnership that owns a residential building or a certified Canadian film production. For the purpose of computing adjusted taxable income under the minimum tax, the individual is treated as having claimed capital cost allowance claimed by the partnership in the same proportion as the individual's share of the partnership income.

Subsection 127.52(2) is amended to apply to any amount deductible in computing the income or loss of a partnership. Where an amount deductible by a partnership is relevant for the purpose of computing the adjusted taxable income of an individual who is a member of the

partnership, the individual is treated as having claimed the partnership's deductible amounts in the same proportion as the individual's share of the partnership income or loss.

This amendment applies to taxation years of an individual that begin after 1994.

Subclause 76(7)

ITA
127.52(2.1)

New subsection 127.52(2.1) of the Act provides an anti-avoidance rule that applies where one of the main reasons that a member of a partnership was not a specified member of the partnership since becoming a member of the partnership is to avoid the application of the "adjusted taxable income" computation under section 127.52 of the Act in respect of determining an individual's minimum tax for a year.

In such cases, the member shall be considered to have been a specified member of the partnership at all times since becoming a member of the partnership. This subsection applies after April 26, 1995.

Subclauses 76(8) and (9)

ITA
127.52(3)

Subsection 127.52(3) of the Act defines the terms "film property" and "residential property" for the purpose of computing an individual's adjusted taxable income under the minimum tax. Subsection 127.52(3) is amended to repeal the definition "residential property" and to add the definitions "limited partner" and "rental or leasing property".

These amendments apply to taxation years of an individual that begin after 1994.

Example of Application of Section 127.52 of the Act

Example A:

Regular Part I Computation of Taxable Income		Section 127.52 Computation of Taxable Income	
Facts concerning the individual's share of income and losses of the limited partnership.	Income computation ignoring Minimum Tax	Income computation for purposes of Minimum Tax	Reason for adjustment
Business Loss	($10,000)	($8,000)	The 127.52(1)(c.1)(ii) limit on the loss is lesser of: A: 10,000 (amount of loss); and B: **8,000** (amount of 8,000 business tcgs in excess of nil acls)
Taxable capital gain from disposition of property used in above-noted business	$6,000	$8,000	127.52(1)(d)
Taxable capital gain from disposition of other partnership (non-business) property	$9,000	$12,000	127.52(1)(d)
Individual's Taxable Income	$5,000	$12,000	There is a $7,000 adjustment for Minimum Tax purposes

Example B:

Regular Part I Computation of Taxable Income		Section 127.52 Computation of Taxable Income	
Facts concerning the individual's share of income and losses of the limited partnership.	Income computation ignoring Minimum Tax	Income computation for purposes of Minimum Tax	Reason for adjustment
Business Loss before CCA	($10,000)	$0	The 127.52(1)(c.1)(ii) loss limit is lesser of: A: 10,000 (amount of loss); B: **Nil** (amount of 8,000 business tcgs in excess of 8,000 acls)
Taxable capital gain from disposition of property used in above-noted business	$6,000	$8,000	127.52(1)(d)
Allowable capital loss from disposition of other partnership (non-business) property	($6,000)	($8,000)	127.52(1)(d); the loss limit in 127.52(1)(c.1)(i) is the lesser of: A: 20,000 (amount of tcgs:12K+8k); B: **8,000** (amount of loss)
Taxable capital gain from disposition of other partnership (non-business) property	$9,000	$12,000	127.52(1)(d)
Individual's Taxable Income	($1,000)	$12,000	There is a $13,000 adjustment for Minimum Tax purposes

Clause 77

Minimum Tax - Exceptions

ITA
127.55

Section 127.55 of the Act exempts individuals from the minimum tax in certain limited circumstances.

Section 127.5 of the Act previously exempted certain related segregated fund trusts and mutual fund trusts from the application of the minimum tax. These exemptions are now included in new paragraph 127.55(f), which also applies to a trust prescribed to be a master trust under section 5001 of the *Income Tax Regulations*. One of the conditions that a master trust must satisfy is that each of its beneficiaries must be a trust governed by a registered pension plan or a deferred profit sharing plan.

This amendment applies to the 1992 and subsequent taxation years.

Clause 78

Bankrupt Individuals

ITA
128(2)

Subsection 128(2) of the Act contains special rules that apply to individuals who become bankrupt.

Under paragraph 128(2)(d) of the Act, where an individual becomes bankrupt in a calendar year, a taxation year of the individual is deemed to have ended on the day before the bankruptcy and a new taxation year of the individual is deemed to have begun on the day of the bankruptcy.

In the calendar year in which the individual becomes bankrupt, a number of income tax returns must be filed by, or on behalf of, the individual:

- a return to be filed for the taxation year that ends on the day before the bankruptcy;

- a return to be filed under paragraph 128(2)(e) of the Act by the trustee in bankruptcy with respect to certain income of the estate and business of the individual for each taxation year in that calendar year; and

- a separate return to be filed by the individual for the taxation year that begins on the day of bankruptcy.

For each subsequent calendar year during which the individual is bankrupt, the trustee and the individual are each required to file an income tax return in respect of the income of the individual.

A number of the rules set out in subsection 128(2) prevent double reporting of income and double deducting of amounts in computing taxable income and tax payable for a taxation year. In particular, these rules:

- allocate the income of the individual for a year between the returns that are to be filed by the trustee and the individual;

- limit certain deductions that may be made by the trustee and the individual in computing taxable income for the year; and

- limit certain deductions that may be made by the trustee and the individual in determining the tax payable for the year.

Further, paragraph 128(2)(g) sets a restriction on losses that might otherwise be carried forward under section 111 of the Act after the individual is absolutely discharged from bankruptcy.

Subsection 128(2) is amended to expand these rules effective for bankruptcies that occur after April 26, 1995.

The amendments to subsection 128(2) are part of a package of amendments relating to bankruptcies. Other changes include the introduction of new section 118.95 to the Act dealing with the proration of personal tax credits, an amendment to section 120.2 dealing with minimum tax carry-over, amendments to sections 122.5 and 122.61 dealing with the Goods and Services Tax Credit and

Child Tax Benefit, and an amendment to 127.1 dealing with the refundable investment tax credit.

Subclause 78(1)

ITA
128(2)(e)

A trustee in bankruptcy for a bankrupt individual is currently required under paragraph 128(2)(e) of the Act to file an income tax return on behalf of the bankrupt individual as if:

- the only income of the individual for a taxation year were the income for the year arising from dealings in the estate or the carrying on of a business of the bankrupt by the trustee;
- the individual were not entitled to deduct any amount under Division C (computation of taxable income) for the year except under section 111 of the Act (loss carry-overs); and
- the individual were not entitled to deduct any amount under sections 118 to 118.3, 118.5, 118.6, 118.8 and 118.9 of the Act (various credits and deductions available to individuals).

Subparagraph 128(2)(e)(ii) is amended to allow the trustee in bankruptcy to deduct amounts under paragraphs 110(1)(d), (d.1), (d.2) and (d.3) (stocks options, etc.) and section 110.6 (capital gains exemption) in Division C of the Act in computing taxable income of the individual. Any such deduction must be in respect of an amount that the trustee is required to include in income under subparagraph 128(2)(e)(i).

Subparagraph 128(2)(e)(ii) is further amended to allow the trustee to deduct under section 111 of the Act (loss carry-overs) an amount in respect of losses of the bankrupt, such as capital losses, non-capital losses and limited partnership losses, arising in taxation years that end before the bankrupt is absolutely discharged from bankruptcy. Losses referred to in section 111 for taxation years ending after the bankrupt is absolutely discharged from bankruptcy cannot be carried back to be applied against the income of the bankrupt for any taxation year that ends before the bankrupt is so discharged.

Subparagraph 128(2)(e)(iii) is amended to allow the trustee to deduct an amount under section 118.1 (charitable gifts) with respect to gifts made by the bankrupt before the individual became bankrupt.

Subparagraph 128(2)(e)(iii) is also amended to limit the deduction under subsection 127(5) of the Act (investment tax credits) in computing tax payable. This amendment restricts the carrying back of investment tax credits arising from expenditures incurred or properties acquired in taxation years ending after the bankrupt is absolutely discharged.

The amendments to paragraph 128(2)(e) apply to bankruptcies that occur after April 26, 1995.

Subclause 78(2)

ITA
128(2)(f)

An individual who is bankrupt at any time during a taxation year is required under paragraph 128(2)(f) of the Act to file an income tax return for the year. This return is in addition to the return that is required under paragraph 128(2)(e) of the Act to be filed by the trustee in bankruptcy on behalf of the bankrupt individual for the same taxation year. The income for a taxation year to be reported in a return required to be filed under paragraph (f) is computed as if:

- the income of the individual for the year did not include income that is required to be reported by the trustee under paragraph (e) for the year;

- the individual were not entitled to deduct for the year any loss sustained by the trustee in the year in dealing with the estate of or in carrying on the business of the bankrupt individual; and

- the individual were not entitled to deduct for the year any amount under section 111.

Paragraph 128(2)(f) is amended to deny the bankrupt individual any deduction under paragraph 110(1)(d), (d.1), (d.2) or (d.3) (stock options, etc.) or section 110.6 (capital gains exemption) of the Act in respect of an amount included in income under

subparagraph 128(2)(e)(i) for a taxation year. However, new clause 128(2)(e)(ii)(A) allows the trustee on behalf of the bankrupt to deduct any such amount for the year.

Paragraph 128(2)(f) is further amended to deny the bankrupt any deduction under section 118.1 (charitable gifts), 120.2 (minimum tax carry-over), or subsection 127(5) (investment tax credit) of the Act for a year. However, under amended paragraphs 120.2(4)(a) and 128(2)(e) of the Act, the trustee may deduct an amount under section 118.1 or 120.2 or subsection 127(5) of the Act under certain circumstances. For further details, reference may be made to the commentary on those amendments.

The amendments to paragraph 128(2)(f) apply to bankruptcies that occur after April 26, 1995.

Subclause 78(3)

ITA
128(2)(g)

Paragraph 128(2)(g) of the Act currently restricts an individual who is discharged absolutely from bankruptcy from deducting under section 111 of the Act losses that arose for taxation years ending before the individual is so discharged. Any such losses may not be deducted by the individual under section 111 in computing income for taxation years ending after the individual is so discharged.

Paragraph 128(2)(g) is amended to restrict the individual from deducting certain amounts under sections 118.1 (charitable gifts) and 120.2 (minimum tax carry-over) and subsection 127(5) (investment tax credit) of the Act for taxation years (the "subsequent years") that end after the individual is absolutely discharged.

First, the individual cannot deduct under section 120.2 of the Act for subsequent years any minimum tax carry-over arising in respect of minimum tax exigible for taxation years ending before the individual is absolutely discharged. As a result, the individual may not reduce the individual's Part I tax liability for the subsequent years using any such carry-over.

Second, the individual may not deduct under section 118.1 for subsequent years an amount in respect of gifts made by the individual in taxation years ending before the individual is absolutely discharged.

Lastly, the individual may not deduct under subsection 127(5), for subsequent years, any investment tax credit in respect of expenditures incurred or property acquired by the individual in taxation years ending before the individual is absolutely discharged.

The amendments to paragraph 128(2)(g) apply to bankruptcies that occur after April 26, 1995.

Subclause 78(4)

ITA
128(3)

Subsection 128(3) of the Act provides that, in section 128, the terms "bankrupt" and "estate of the bankrupt" have the meanings assigned by the *Bankruptcy and Insolvency Act*. As recent amendments to the Act (in Bill C-70) added these same definitions to section 248 of the Act, subsection 128(3) is no longer required, and is therefore repealed. The repeal of subsection 128(3) applies to bankruptcies that occur after April 26, 1995.

Clause 79

Immigration - paid-up capital

ITA
128.1(2)

Subsection 128.1(2) of the Act applies a formula to adjust the paid-up capital of the shares of a corporation that becomes resident in Canada. As a consequence of changes to Part XIV of the Act, a reference (in paragraph (c) of the description of the variable C in the formula) to paragraph 219(1)(h) of the Act is replaced with a reference to paragraph 219(1)(j).

This amendment generally applies to taxation years that begin after 1995. Since the existing reference to paragraph 219(1)(h) may remain relevant for taxation years that begin in 1996, a transitional version of the amendment leaves both references in place for such taxation years.

Clause 80

Dividend Refund

ITA
129(1)(b)

If a corporation has filed its tax return for a taxation year within 3 years from the end of the year and the Minister of National Revenue has not paid a "dividend refund" upon issuing the assessment of tax for the year, paragraph 129(1)(b) of the Act allows the corporation to make an application for the refund within the period determined under paragraph 152(4)(b) or (c) within which the Minister can reassess tax payable by the corporation for the year. The amendments to paragraph 129(1)(b) are strictly consequential on the amendments to subsection 152(4) and effect no substantive changes to this provision. Amended paragraph 129(1)(b) applies after April 27, 1989.

Clause 81

Investment Corporations

ITA
130

Section 130 of the Act sets out special rules relating to the taxation of investment corporations.

Subclause 81(1)

ITA
130(2)

As a flow-through vehicle, an investment corporation can pass its capital gains on to its shareholders in the form of capital gains dividends. Such dividends are treated as capital gains in the hands of the shareholders, while the corporation receives a refund of the tax it paid on the gains. This special treatment is made available by subsection 130(2) of the Act, which adapts the capital gains dividend rules for mutual fund corporations (subsections 131(1) to (3.2) of the Act) to investment corporations.

In its current form, subsection 130(2) applies to a corporation that was throughout a taxation year an investment corporation other than a mutual fund corporation. As a result, a corporation that is an investment corporation throughout a taxation year, but that becomes a mutual fund corporation part-way through the year, may lose its entitlement to capital gains dividend treatment. This amendment, which applies to the 1993 and subsequent taxation years, prevents that inappropriate result. The amendment also ensures that the relevant definitions in subsection 131(6) of the Act apply for the purposes of subsection 130(2).

Subclause 81(2)

ITA
130(3)(a)(vii)

Paragraph 130(3)(a) of the Act sets out the conditions under which a corporation is considered to be an investment corporation. Among those conditions is, in subparagraph 130(3)(a)(vii), a requirement that no shareholder hold more than 25% of the shares of the corporation. This amendment expands that rule. In effect, a person will be considered for the purpose of the 25% test to own not only any shares that person actually owns, but also (1) any shares owned by persons with whom that person does not deal at arm’s length, and (2) a proportionate number of any shares held by a trust of which that person is a beneficiary or a partnership of which that person is a member. This expanded test will apply to any person who acquires a share of the corporation after ANNOUNCEMENT DATE.

More specifically, under amended subparagraph 130(3)(a)(vii) a corporation will be an investment corporation only if no person acquiring shares of the corporation after ANNOUNCEMENT DATE would be a specified shareholder of the corporation if the references to "not less than 10%" in the definition "specified shareholder" in subsection 248(1) of the Act were references to "more than 25%".

This amendment applies to taxation years that begin after ANNOUNCEMENT DATE. A significant exception applies to corporations that were investment corporations on ANNOUNCEMENT DATE and that had on that date one or more shareholders to whom the new 25% test would otherwise apply. In such a case, the application of amended subparagraph 130(3)(a)(vii) will depend on whether the shareholder (who may, together with all non-arm's length persons, be called for this purpose an "existing 26% specified shareholder") acquires additional shares of the corporation after ANNOUNCEMENT DATE, and if so how those additional shares are acquired.

As long as an existing 26% specified shareholder does not acquire additional shares of the corporation, or contribute additional capital to it, amended subparagraph 130(3)(a)(vii) does not apply in respect of that shareholder's interest in the corporation. Assuming it meets the Act's other requirements, the corporation can remain an investment corporation.

If an existing 26% specified shareholder acquires additional shares of the corporation by way of stock dividend, or acquires shares that were held continuously since ANNOUNCEMENT DATE by one or more persons who were related to the existing 26% specified shareholder throughout, the amended version of subparagraph 130(3)(a)(vii) is read in a special manner. The subparagraph is read as though instead of limiting shareholdings to 25%, it limited them to the greatest percentage of the shares of any class of the corporation's stock that were held at the end of ANNOUNCEMENT DATE by the existing 26% specified shareholder and non-arm's length persons.

EXAMPLE:

> *Assume that F, an individual, holds on ANNOUNCEMENT DATE 24% of the Class A shares of an investment corporation, and 15% of the Class B shares. M, the spouse of F, also holds 24% of the Class A shares and 15% of the Class B shares.*
>
> *Since F and M together hold more than 25% of the shares of a class of the corporation's capital stock, they are each what these notes have called an existing 26% specified shareholder of the corporation. If neither F nor M (nor any other person who does not deal with either of them at arm's length) ever acquires another share of the corporation, amended subparagraph 130(3)(a)(vii) will not apply to their shareholdings.*
>
> *F and M may, however, acquire shares from one another – or from other related persons – without causing the corporation to cease to be an investment corporation, provided the shares have been held since ANNOUNCEMENT DATE by one or more persons who have been related to the acquiring shareholder since then. They may also acquire shares from the corporation as stock dividends. In no event, though, may F or M (together with all non-arm's length persons) hold more than 48% of the shares of any class of the corporation's capital stock. This is because on ANNOUNCEMENT DATE each of them held, together with all non-arm's length persons, 48% of the corporation's Class A shares.*

Clause 82

Definition of Mortgage Investment Corporation

ITA
130.1(6)

Section 130.1 of the Act sets out rules that apply to mortgage investment corporations and their shareholders. Subsection 130.1(6) defines "mortgage investment corporation" for these purposes.

Subparagraph 130.1(6)(f)(i) refers to "residential property" as defined in the *Residential Mortgage Financing Act*. That Act, which defined

"residential property" by reference to definitions contained in the *National Housing Act*, was repealed in 1993. This amendment to subparagraph 130.1(6)(f)(i) therefore replaces the term "residential property" with the corresponding terms in the *National Housing Act*, so that the substance of the paragraph remains unchanged.

This amendment applies as of June 23, 1993, the date on which the *Residential Mortgage Financing Act* was repealed.

Clause 83

Mutual Fund Corporations

ITA
131

Section 131 sets out rules relating to the taxation of mutual fund corporations and their shareholders.

Subclause 83(1)

ITA
131(2)(b)

If a mutual fund corporation has filed its tax return for a taxation year within 3 years from the end of the year and the Minister of National Revenue has not paid a "capital gains refund" upon issuing the assessment of tax for the year, paragraph 131(2)(b) of the Act allows the corporation to make an application for the refund within the period determined under paragraph 152(4)(b) or (c) within which the Minister can reassess tax payable by the corporation for the year. The amendments to paragraph 131(2)(b) are strictly consequential on the amendments to subsection 152(4) and effect no substantive changes to this provision. Amended paragraph 131(2)(b) applies after April 27, 1989.

Subclause 83(2)

ITA
131(5)

Subsection 131(5) of the Act treats a mutual fund corporation as a private corporation for the purposes of the refundable tax imposed under Part IV of the Act on private and certain other ("subject") corporations.

This amendment makes two changes to subsection 131(5). First, it simplifies the description of a mutual fund corporation's refundable dividend tax on hand (RDTOH). Second, it restructures the provision to ensure that a mutual fund corporation does not lose access to its RDTOH if it becomes an investment corporation, or if it has ceased to be a subject corporation.

The amendment applies to the 1994 and subsequent taxation years.

Subclause 83(3)

ITA
131(8)

Subsection 131(8) of the Act sets out the definition of "mutual fund corporation".

The definition is amended so that "interests" in real property, as defined by subsection 248(4), are treated in the same manner as real property for the purposes of determining whether a corporation is a mutual fund corporation. Under subsection 248(4), an "interest" in real property includes a leasehold interest in real property.

This amendment applies to the 1994 and subsequent taxation years.

Clause 84

Mutual Fund Trusts

ITA
132

Section 132 contains special rules relating to the taxation of mutual fund trusts.

Subclause 84(1)

ITA
132(1)(b)

If a mutual fund trust has filed its tax return for a taxation year within 3 years from the end of the year and the Minister of National Revenue has not paid a "capital gains refund" upon issuing the assessment of tax for the year, paragraph 132(1)(b) of the Act allows the trust to make an application for the refund within the period determined under paragraph 152(4)(b) or (c) within which the Minister can reassess tax payable by the trust for the year. The amendments to paragraph 132(1)(b) are strictly consequential on the amendments to subsection 152(4) and effect no substantive changes to this provision. Amended paragraph 132(1)(b) applies after April 27, 1989.

Subclauses 84(2) and (3)

Meaning of "mutual fund trust"

ITA
132(6)

Subsection 132(6) of the Act sets out the definition of "mutual fund trust". Under the definition, if a trust becomes a mutual fund trust on or before the day on which it must file its return for its first taxation year, it can elect to be deemed to have been a mutual fund trust from the start of its first taxation year to the day on which it first met the requirements. Consequential to the addition of new subsection 132(6.1), the portion of subsection 132(6) providing the election is repealed.

The definition is also amended so that "interests" in real property, as defined by subsection 248(4), are treated in the same manner as real property for the purposes of determining whether a trust is a mutual fund trust. Under subsection 248(4), an "interest" in real property includes a leasehold interest in real property.

These amendments apply to the 1994 and subsequent taxation years.

Subclause 84(4)

Election to be mutual fund

ITA
132(6.1)

New subsection 132(6.1) provides that where a trust becomes a mutual fund trust at any time before the 91st day after the end of the calendar year in which it was created and the trust elects in its first return of income under Part I, the trust is treated as having been a mutual fund trust from the day it was created. The subsection replaces the election previously available under subsection 132(6) which required that a trust make such an election on or before its balance due date for its first taxation year. The amendment applies to the 1994 and subsequent taxation years.

Clause 85

Mutual Fund Reorganizations

ITA
132.2(1)

Section 132.2 of the Act provides for "qualifying exchanges" between mutual funds. In a qualifying exchange, one mutual fund transfers all or substantially all of its property to another mutual fund, and takes back units of the transferee fund. The transferor fund's investors then exchange their shares or units of the transferor for those units of the transferee fund. Both sets of transactions take place on a tax-deferred or "rollover" basis. The qualifying exchange thus allows two mutual funds to be merged with no immediate tax consequence.

Section 132.2 is amended in three respects. First, a new paragraph is inserted (amended paragraph (p)) to ensure the appropriate computation of the transferor and transferee fund's capital gains redemptions under subsection 131(6) or 132(4) of the Act for its taxation year that includes the beginning of the qualifying exchange. A fund's capital gains redemptions are that proportion of both its realized and its latent capital gains that is presumed to have been distributed to investors on redemptions as gains on their investments. Since under the present rules the units of the transferee taken back by the transferor on a qualifying exchange have a cost amount of nil for all purposes, the transferor's latent gain on those units will likely be overstated. Similarly, the transferee's capital gains redemptions for its last taxation year beginning before the exchange occurs could be distorted by the inclusion of the value of the units issued by the transferee to the transferor, or by the inclusion of the assets or liabilities assumed by the transferee, on the exchange.

To prevent these potential distortions, amended paragraph (p) treats the taxation years of both the transferor and transferee fund, that would otherwise have ended at the time at which the transferee fund acquired the property on the qualifying exchange, as having ended immediately before the time at which that property was transferred from the transferor to the transferee fund. In providing this treatment – which applies only for the purposes of subsections 131(6) and 132(4) of the Act – each fund will calculate its capital gains redemptions for its last taxation year beginning before the exchange on the basis of its outstanding shares or units, its properties, and its liabilities, without taking the effects of the exchange into account. A consequential amendment to paragraph 132.2(1)(h) confirms that the special rule in amended paragraph (p) overrides the general rule with respect to the cost of the property taken back on the exchange by the transferor.

The second change to section 132.2 confirms that a qualifying exchange does not constitute a deemed dividend to the investors in the transferor fund.

Where the transferor fund is a corporation, its investors' exchange of their shares for units of the transferee may constitute an acquisition of those shares by the transferor. Subsection 84(3) of the Act provides that on the redemption, acquisition or cancellation of its shares, a corporation is treated as having paid a dividend. Subsection 131(4) of

the Act, however, prevents section 84 from applying to mutual fund corporations. If the transferor fund is a mutual fund corporation when its investors exchange their shares for units of the transferee, then the investors will not be treated as having received a dividend.

To ensure that no deemed dividend arises on a qualifying exchange, paragraph 132.2(1)(o) of the Act is amended to provide that where, as part of a qualifying exchange, an investor disposes of a share of the transferor, for the purposes of subsection 131(4) the transferor will be treated as being a mutual fund at the time of that disposition.

Existing paragraph 132.2(1)(p) of the Act, which precludes the transferor fund from continuing to be treated as a mutual fund, is amended to accommodate the change to paragraph (o), and is renamed as paragraph (q).

Finally, the definition of "qualifying exchange" in subsection 132.2 is amended to accommodate the exercise of statutory dissent rights by investors in the transferor fund. Despite the general rule in paragraph (b) of that definition, that any person disposing of shares of the transferor within the 60-day period of the exchange may receive only units of the transferee in return, the fact that an investor chooses to exercise dissent rights rather than participating in the exchange will not disqualify the transaction as a qualifying exchange.

These changes apply as of the July 1, 1994 coming-into-force of the qualifying exchange rules.

Clause 86

Non-Resident-Owned Investment Corporations

ITA
133(6)(b)

If a non-resident-owned investment corporation has filed its tax return for a taxation year within 3 years from the end of the year and the Minister of National Revenue has not paid an "allowable refund" upon issuing the assessment of tax for the year, paragraph 133(6)(b) of the Act allows the corporation to make an application for the refund within the period determined under paragraph 152(4)(b) or (c)

within which the Minister can reassess tax payable by the corporation for the year. The amendments to paragraph 133(6)(b) are strictly consequential on the amendments to subsection 152(4) and effect no substantive changes to this provision. Amended paragraph 133(6)(b) applies after April 27, 1989.

Clause 87

Cooperative not private corporation

ITA
136(1)

Subsection 136(1) of the Act provides that cooperative corporations that would otherwise be private corporations are considered not to be private corporations, except for the purposes of certain provisions of the Act listed in that subsection. Subsection 136(1) is amended to add to the list the definition of "mark-to-market property" in subsection 142.2(1) of the Act. Thus, a cooperative that is a private corporation retains its status for the purpose of that definition and any regulations made under the definition. At present, whether a cooperative is a private corporation is relevant only for proposed subsection 9001(1) of the *Income Tax Regulations*, which prescribes certain small business corporation shares for the purpose of paragraph (e) of the definition of mark-to-market property.

The amendment to subsection 136(1) applies to taxation years that end after February 22, 1994.

Clause 88

Insurer - not private corporation

ITA
141.1

Section 141.1 of the Act provides that for many purposes an insurance corporation (other than a life insurance corporation) is not treated as a private corporation. The section is amended to include among those the new refundable additional tax on the investment

income of Canadian-controlled private corporations, in section 123.2 of the Act.

To coincide with the introduction of section 123.2, this amendment applies to taxation years that end after June 1995.

Clause 89

Definition of "specified debt obligation"

ITA
142.2(1)

A "specified debt obligation" of a taxpayer is the taxpayer's interest in a loan, bond, debenture, mortgage, note, agreement of sale or any other similar indebtedness, or in any debt obligation purchased by the taxpayer. However, it does not include an interest in an income bond, an income debenture, a small business development bond, a small business bond or a prescribed property. The amendment excludes from the definition any instrument issued by or made with a person to whom the taxpayer is related or with whom the taxpayer does not otherwise deal at arm's length, or in which the taxpayer has a significant interest. Such instruments will continue to be dealt with outside the new mark-to-market property rules. The amendment applies to taxation years that end after February 22, 1994.

Clause 90

Income from specified debt obligations

Subclauses 90(1) and (2)

ITA
142.3(1)

Subsection 142.3(1) of the Act provides that the amounts included or deducted in respect of a specified debt obligation (as defined in subsection 142.2(1) of the Act) in computing the income of a financial institution are to be determined in accordance with rules set out in the Regulations. Two consequential amendments are made to

subsection 142.3(1): (i) the reference to subsection 142.3(2) is changed to subsection 142.3(3) as a consequence of the renumbering of that provision; and (ii) paragraph 142.3(1)(c) is amended so that it allows new subsection 142.3(2) to apply with respect to the determination of amounts to be included or deducted in respect of specified debt obligations. These amendments apply to taxation years that end after February 22, 1994, except that they do not apply to a debt obligation disposed of before February 23, 1994.

Subclause 90(3)

ITA
142.3(2) and (3)

Subsection 142.3(2) provides that subsection 142.3(1) does not apply to specified debt obligations that are mark-to-market properties, nor does it apply to indexed debt obligations (as defined in subsection 248(1) of the Act). This subsection is renumbered as subsection 142.3(3) and is amended so that it also applies for the purpose of new subsection 142.3(2). The latter amendment is made because of the reference in new subsection 142.3(2) to amounts required by subsection 12(3) to be included in a taxpayer's income in respect of specified debt obligations.

New subsection 142.3(2) applies where a financial institution has failed to include an amount in income in respect of a specified debt obligation, as required by paragraph 142.3(1)(a). Subsection 142.3(2) provides that the amount is to be included in computing the financial institution's income for a subsequent taxation year in which it still holds the obligation, except to the extent that the amount has been included in computing income for a preceding taxation year. This rule is similar to the requirement in subsection 12(3) of the Act that all interest that has accrued to a taxpayer or was received by the taxpayer to the end of a taxation year be included in computing the taxpayer's income for the year, to the extent that it was not included in computing the taxpayer's income for a preceding taxation year.

Subsection 142.3(2) also applies if a financial institution has not included an amount in income as required by subsection 12(3). This is relevant for specified debt obligations that were acquired before subsection 142.3(1) began to apply to the taxpayer. If a taxpayer failed to report an amount as required by subsection 12(3), that

subsection will not apply to later years when the tax treatment of the obligation is governed by subsection 142.3(1).

These amendments apply to taxation years ending after February 22, 1994, except that they do not apply to debt obligations disposed of before February 23, 1994.

Clause 91

Disposition of specified debt obligations

ITA
142.4

Section 142.4 of the Act contains rules for the measurement and treatment of the gain or loss realized by a financial institution on the disposition of a specified debt obligation (other than a mark-to-market property). The amendments to this section apply to taxation years that end after February 22, 1994.

Subclauses 91(1) and (2)

Definition of "tax basis"

ITA
142.4(1)

Subsection 142.4(1) defines the tax basis of a specified debt obligation. The tax basis, which is analogous to the adjusted cost base of a capital property, is used to measure the gain or loss from a disposition of the obligation. Paragraphs (b) and (j) of the definition are amended.

Paragraph (b) of the definition adds to the tax basis of a specified debt obligation amounts included by several provisions in respect of the obligation in computing the income of the taxpayer. This paragraph is amended to add a reference to new subsection 142.3(2).

Paragraph (j) of the definition reduces the tax basis of a specified debt obligation to a taxpayer by the amount of a payment received by the taxpayer under the obligation where the payment is in respect of

an amount included in the tax basis by any of paragraphs (a) to (f) of the definition and is not proceeds of disposition. Paragraph (j) is amended to provide that the tax basis of a specified debt obligation is reduced by all payments received by the taxpayer under the obligation, other than a payment that is proceeds of disposition or a fee or similar amount.

Subclause 91(3)

Rules applicable to disposition

ITA
142.4(3)

Paragraph 142.4(3)(a) provides that where a taxpayer disposes of a specified debt obligation after February 22, 1994, no amount will be included or deducted in respect of the disposition except as provided by section 142.4. Other provisions of the Act do not apply.

Paragraph 142.4(3)(a) is amended to permit paragraph 79.1(7)(d) to apply where a taxpayer disposes of a specified debt obligation. Accordingly, where a financial institution forecloses on the security under a loan, the financial institution will be able to claim a deduction under 79.1(7)(d) in respect of any accrued but unpaid interest the financial institution has been required to include in income under paragraph 142.3(1)(a).

Subclause 91(4)

Inclusions and deductions re disposition

ITA
142.4(4)

Subsection 142.4(4) applies to the disposition of a specified debt obligation after 1994, except a disposition to which subsection 142.4(5) applies. It requires the taxpayer to include or deduct amounts in respect of the disposition in computing income.

The amendments to subsection 142.4(4) are consequential on the amendment of the definition of "current amount" in subsection 142.4(7). They do not change the net amount required by

subsection 142.4(4) to be included or deducted in respect of a disposition in computing income. The definition of "current amount" is amended so that it does not include the transition amount in respect of the disposition. Thus, it is just the credit-related component of a gain or loss.

As amended, paragraph 142.4(4)(a) applies where the transition amount in respect of the disposition of a specified debt obligation is positive. It requires the transition amount to be included in computing the taxpayer's income for the taxation year in which the disposition occurs. Paragraph 142.4(4)(b) provides for an amount equal to the absolute value of the transition amount to be deducted if the transition amount is negative.

Paragraph 142.4(4)(c), which applies where a taxpayer has a gain from the disposition of a specified debt obligation, requires the current amount of the gain to be included in income in the year of disposition, and requires a prescribed part of the residual portion of the gain (as defined in subsection 142.4(8)) to be included in income each year, starting in the year of disposition. Proposed Part XCII of the *Income Tax Regulations* will contain the rules for amortizing the residual portion of a gain.

Paragraph 142.4(4)(d), which is similar to paragraph 142.4(4)(c), provides for deductions where a taxpayer has a loss from the disposition of a specified debt obligation.

Gain or loss not amortized

ITA
142.4(5)

Subsection 142.4(5) provides that the full gain or loss from the disposition after February 22, 1994 of certain specified debt obligations is to be included or deducted in computing income for the taxation year in which the disposition occurs. This subsection is replaced by a new subsection 142.4(5) that differs from the existing subsection in the following respects:

- a new paragraph 142.4(5)(c) is added;

- existing paragraph 142.4(5)(c) is relabelled as paragraph (d); and

- existing paragraphs 142.4(5)(d) and (e) are replaced by new paragraphs 142.4(5)(e) and (f).

New paragraph 142.4(5)(c) permits a taxpayer (other than a life insurance corporation) to elect to postpone the commencement of the amortization requirement for gains and losses. If the election is made, subsection 142.4(5) applies to all dispositions of specified debt obligations before 1996. The election must be in writing and filed with the Minister of National Revenue before July 1997.

New paragraph 142.4(5)(e) provides that the amount to be included in a taxpayer's income in respect of the disposition of a specified debt obligation is the amount, if any, by which the taxpayer's proceeds of disposition exceed the tax basis of the obligation.
Paragraph 142.4(5)(f) contains a similar rule for the measurement and deduction of a loss. Currently, the corresponding provisions in paragraphs 142.4(5)(d) and (e) refer to the gain or loss determined under subsection 142.4(6). This amendment to subsection 142.4(5) does not affect the amount of the gains and losses to be recognized, but is made so that subsection 142.4(6) can be simplified.

Subclauses 91(5) and (6)

Gain or loss from disposition of obligation

ITA
142.4(6)

Subsection 142.4(6) provides for the determination of a taxpayer's gain or loss from the disposition of a specified debt obligation. The gain or loss is equal to

- the taxpayer's proceeds of disposition

minus

- the tax basis of the obligation to the taxpayer, and

- if subsection 142.4(4) applies to the disposition, the taxpayer's transition amount (as defined in subsection 142.4(1) of the Act) in respect of the obligation. (If the transition amount is negative, the absolute value of that amount is added.)

Two amendments are made to subsection 142.4(6).
Paragraph 142.4(6)(b) is amended so that a loss from a disposition is expressed as a positive amount rather than a negative amount. The second amendment, which is made to the description of C in the formula in the subsection, provides for the transition amount to always be taken into account in determining the gain or loss. A related amendment is made to subsection 142.4(5) so that subsection does not use the gain or loss as determined under subsection 142.4(6), but instead provides a separate determination of the gain or loss for the purpose of that subsection.

Subclause 91(7)

Current amount

ITA
142.4(7)

Subsection 142.4(7) defines the current amount in respect of the disposition of a specified debt obligation by a taxpayer. It is the positive or negative amount equal to the sum of the transition amount in respect of the obligation and the credit-related portion of the gain or loss from the disposition (with the credit-related portion of a loss treated as a negative amount).

Subsection 142.4(7) is amended to define the current amount to be the credit-related portion of the gain or loss from the disposition of a specified debt obligation. The transition amount is not included as part of the current amount. Also, the current amount is a positive amount whether there was a gain or a loss. A related amendment to subsection 142.4(4) provides for the separate inclusion or deduction of the transition amount in computing income. These amendments do not make any substantive changes to the current rules.

Residual portion of gain or loss

ITA
142.4(8)

Subsection 142.4(8) defines the residual portion of a taxpayer's gain or loss from the disposition of a specified debt obligation. The amendment to subsection 142.4(8) is consequential on the amendment

to subsection 142.4(7), and does not change the determination of the residual portion.

Disposition of part of obligation

ITA
142.4(9)

Subsection 142.4(9) provides that where a financial institution disposes of part of a specified debt obligation, section 142.4 and the regulations made for the purpose of the section apply as if that part and the retained part were separate debt obligations. This subsection is amended so that it also applies for the purposes of section 142.3. In addition, the reference to "regulations" is deleted, since subsection 142.4(9) applies to the *Income Tax Regulations* without explicitly referring to them.

Penalties and bonuses

ITA
142.4(10)

New subsection 142.4(10) provides that a penalty or bonus received by a taxpayer in respect of the early repayment of a specified debt obligation is to be treated as part of the proceeds of disposition of the obligation. Subsection 142.4(10) applies instead of subsection 18(9.1), where that latter subsection would otherwise apply to deem the amount to be received as interest.

Payments received on or after disposition

ITA
142.4(11)

New subsection 142.4(11) provides that a payment (other than proceeds of disposition) received by a taxpayer under a specified debt obligation on or after the disposition of the obligation shall be considered to have been received immediately before the disposition. Consequently, the payment will be taken into account in determining the tax basis of the obligation to the taxpayer immediately before the disposition, and hence in determining the taxpayer’s gain or loss from the disposition.

Clause 92

Mark-to-market properties

Transition - inclusion re non-capital amounts

ITA
142.5(5)

Subsection 142.5(5) applies to a financial institution that has claimed a transition deduction under subsection 142.5(4) in respect of the introduction of the mark-to-market requirement. It requires a prescribed portion of the deducted amount to be included in income in each taxation year starting with the year that includes October 31, 1994. Subsection 142.5(5) is amended to modify the way in which it confers regulation-making authority. This amendment applies to taxation years that end after October 30, 1994.

Transition - deduction re net capital gains

ITA
142.5(6)

Subsection 142.5(6) is a transition rule that applies with respect to capital property that is deemed to be disposed of on the initial application of the mark-to-market requirement. It permits a financial institution to claim an allowable capital loss not exceeding a prescribed amount. The amendment to subsection 142.5(6) provides that, in the case of a taxpayer not resident in Canada, the allowable capital loss is considered to be from the disposition of taxable Canadian property. This amendment applies to taxation years that end after October 30, 1994.

Transition - inclusion re net capital gains

ITA
142.5(7)

Subsection 142.5(7) applies to a financial institution that has elected to claim an allowable capital loss under subsection 142.5(6) for its taxation year that includes October 31, 1994. Subsection 142.5(7)

deems the financial institution to have a taxable capital gain for that year and for subsequent years equal to the portion of the elected amount prescribed for the year. Subsection 142.5(7) is amended to modify the way in which it confers regulation-making authority. It is also amended to provide that, in the case of a taxpayer not resident in Canada, the taxable capital gain is considered to be from the disposition of taxable Canadian property. These amendments apply to taxation years that end after October 30, 1994.

Clause 93

Accrued capital gains and losses election

ITA
142.6(8) to (10)

New subsection 142.6(8) is a transitional rule that applies to properties held by a financial institution in its last taxation year that ended before February 23, 1994. Where a financial institution holds a capital property (other than a depreciable property) in that year that will be a mark-to-market property or a specified debt obligation under the new mark-to-market property rules and on which there is an accrued capital gain, subsection 142.6(8) permits the financial institution to elect – subject to the limits imposed under new subsection 142.6(9) – to realize all or any part of that accrued capital gain. Similarly, where a financial institution holds a capital property (other than a depreciable property) in that year that will not be a mark-to-market property or a specified debt obligation under the new mark-to-market property rules and on which there is an accrued capital loss, the financial institution can elect – subject to the limits imposed under new subsection 142.6(10) – to realize all or any part of that accrued capital loss.

The effect of subsections 142.6(8) to (10) is to permit a financial institution to recognize any capital gains accrued on its assets that were capital properties, and that became mark-to-market properties or specified debt obligations in its first taxation year that ends after February 22, 1994, to offset its capital losses that have been realized or accrued on other properties before the beginning of that year.

New subsection 142.6(9) limits the amount of accrued capital gains a financial institution can elect to realize under subsection 142.6(8). Subsection 142.6(9) will deem an election to realize taxable capital gains under 142.6(8) not to have been made where the election would have the effect of increasing the financial institution's net taxable capital gains – that is, the amount by which the financial institution's taxable capital gains for the year exceed the total of its allowable capital losses for the year and the greatest amount it could claim in the year as a capital loss carryforward.

Subsection 142.6(9) prevents a financial institution from realizing accrued capital gains on mark-to-market properties or specified debt obligations under subsection 142.6(8) unless the financial institution has capital losses (from either actual or elected dispositions) or capital loss carryforwards to offset the elected gains.

Where a financial institution elects to realize an excessive amount of capital gains, the election is deemed not to have been made. However, the financial institution may, within certain time limits, file another election that satisfies the requirements of this subsection (and subsection 142.6(10)).

New subsection 142.6(10) places two limits on the amount of accrued capital losses a financial institution can elect to realize under subsection 142.6(8).

First, under paragraph 142.6(10)(a), an election to realize allowable capital losses under subsection 142.6(8) will be valid only if the financial institution's allowable capital losses (including those sought to be realized under the election) and net capital loss carryforwards would not exceed its taxable capital gains (including those sought to be realized under the election) in the year. Paragraph 142.6(10)(a) restricts the election under subsection 142.6(8) to ensure that a financial institution does not use the election to realize accrued capital losses that it can not use to offset gains in the year in the expectation that it will be able to use those losses in a future year to offset taxable capital gains on other properties while still retaining the capital properties on which the losses accrued.

Second, under paragraph 142.6(10)(b), a financial institution can elect to realize capital losses under paragraph 142.6(8)(b) only to the extent that those losses do not exceed the capital gains it has elected to

realize under paragraph 142.6(8)(a). In other words, a financial institution may realize accrued losses to offset taxable capital gains only where it elected to realize the gains on properties that will be subject to the mark-to-market rules; an election to realize accrued capital losses will not be permitted simply to offset capital gains from actual dispositions made by the taxpayer in its last taxation year that ended before February 23, 1994.

Where a financial institution elects to realize an excessive amount of capital losses, the election is deemed not to have been made. However, the financial institution may, within certain time limits, file another election that satisfies the requirements of this subsection (and subsection 142.6(9)).

New subsections 142.6(8) to (10) apply to the 1993 and subsequent taxation years.

Clause 94

Cost of Tax Shelter Investments

ITA
143.2

New section 143.2 of the Act sets out the rules that apply for the purpose of computing the amount of any expenditure that is, or is the cost or capital cost of, a taxpayer's tax shelter investment. New section 143.2 also applies to the amount of any expenditure of a taxpayer where an interest in the taxpayer is a tax shelter investment. New subsection 143.2(6) provides that a taxpayer is to reduce the amount of, or the cost or capital cost of, an affected expenditure by any limited-recourse amounts that can reasonably be considered to relate to the expenditure and by the taxpayer's at-risk adjustment in respect of the expenditure. The application of these rules is more fully described in the following commentary.

Definitions

ITA
143.2(1)

New subsection 143.2(1) of the Act provides definitions that apply for the purpose of new section 143.2. The terms defined for this purpose are "expenditure", "limited partner", "limited-recourse amount", "taxpayer", and "tax shelter investment". "Limited-recourse amount" means the unpaid principal amount of any indebtedness for which recourse is limited, either immediately or in the future and either absolutely or contingently.

Generally, the definition "tax shelter investment" means a property that is defined to be a "tax shelter" under subsection 237.1(1) of the Act. In certain cases, a taxpayer's interest in a partnership is also considered to be a "tax shelter investment" notwithstanding that the taxpayer's partnership interest is not a "tax shelter" under subsection 237.1(1) of the Act.

New subsection 143.2(1) generally applies to properties acquired and outlays and expenses made or incurred after November 1994.

At-risk Adjustment

ITA
143.2(2)

New subsection 143.2(2) of the Act provides that an "at-risk adjustment" in respect of an expenditure of a particular taxpayer means any amount or benefit that the particular taxpayer, or another taxpayer not dealing at arm's length with the particular taxpayer, is or may be entitled to receive or obtain. This subsection applies where the amount or benefit is intended to protect the particular taxpayer or the other taxpayer from loss in respect of the taxpayer's expenditure. Under new subparagraph 143.2(6)(b)(ii), which generally applies after April 26, 1995, certain expenditures of a taxpayer are reduced by the amount of the taxpayer's at-risk adjustment in respect of the expenditure.

Amount or Benefit Not Included

ITA
143.2(3)

New subsection 143.2(3) of the Act provides circumstances where amounts or benefits are not considered to be amounts or benefits included in a taxpayer's "at-risk adjustment" in respect of an expenditure under new subsection 143.1(2). New subsection 143.2(3) provides that new subsection 143.2(2) does not apply, for example, to the extent that a taxpayer's entitlement to an amount or benefit arises:

- under normal liability insurance protection;
- as a consequence of death of the taxpayer; or
- in respect of an amount not included in the expenditure.

This subsection generally applies after April 26, 1995.

Amount or Benefit

ITA
143.2(4)

New subsection 143.2(4) of the Act provides that, where an amount or benefit referred to in new subsection 143.2(2) is provided by way of an agreement under which a taxpayer has or may have a right to acquire property, the taxpayer is considered to be entitled at any time to an amount or benefit equal to the fair market value of the property at that time.

This subsection generally applies after April 26, 1995.

Amount or Benefit

ITA
143.2(5)

New subsection 143.2(5) of the Act provides that, for the purpose of the at-risk adjustment in new subsection 143.2(2), where a taxpayer, or a person not dealing at arm's length with the taxpayer, has a

borrowing guaranteed or otherwise backed by a security or similar indemnity or covenant, the amount or benefit to which the taxpayer is entitled is considered to be equal to the outstanding balance of the borrowing.

This subsection generally applies after April 26, 1995.

Amount of Expenditure

ITA
143.2(6)

New subsection 143.2(6) of the Act applies to reduce the amount of any expenditure that is, or is the cost or capital cost of, a taxpayer's tax shelter investment by certain amounts. This reduction also applies to the amount of any expenditure of a taxpayer where an interest in the taxpayer is considered to be a tax shelter investment.

New subparagraph 143.2(6)(b)(i) provides a reduction equal to the total of all limited-recourse amounts in respect of an affected expenditure. For this purpose, an expenditure's limited-recourse amount refers to such amounts of the taxpayer and of a taxpayer not dealing at arm's length with the taxpayer, where the particular limited-recourse amount can reasonably be considered to relate to the expenditure. This reduction for limited-recourse amounts occurs at the time the expenditure was acquired, made or incurred including where the limited-recourse amount arises after the acquisition, making or incurring of the expenditure.

New subparagraph 143.2(6)(b)(ii) provides for a reduction of an amount, or cost or capital cost, of an affected expenditure of a taxpayer to the extent of the taxpayer's "at-risk adjustment" in respect of the expenditure.

New subparagraph 143.2(6)(b)(iii) provides for a reduction of an amount, or cost or capital cost, of an affected expenditure of a taxpayer to the extent of each amount (determined under paragraph 143.2(6)(b)) of each other taxpayer who deals at arm's length with and holds, directly or indirectly, an interest in the taxpayer, that can reasonably be considered to relate to the expenditure.

New subparagraphs 143.2(6)(b)(i) and (iii) generally apply to property acquired and to outlays and expenses made or incurred after November 1994. New subparagraph 143.2(6)(b)(ii) generally applies after April 26, 1995.

Repayment of Indebtedness

ITA
143.2(7)

New subsection 143.2(7) of the Act describes circumstances in which the unpaid principal of indebtedness will be deemed to be a limited-recourse amount. This subsection generally applies after November 1994.

Limited-recourse Amount

ITA
143.2(8)

New subsection 143.2(8) of the Act treats the unpaid principal of an indebtedness relating to a taxpayer's expenditure as a limited-recourse amount where the taxpayer is a partnership and recourse against any member of the partnership in respect of the indebtedness is limited, either immediately or in the future and either absolutely or contingently. This subsection applies after November 1994.

Timing

ITA
143.2(9)

New subsection 143.2(9) of the Act sets out rules applicable upon payment of an amount on account of the principal amount of an indebtedness relating to an expenditure to which a subsection 143.2(2) "at-risk" adjustment previously applied. In such circumstances, the "at-risk" adjustment applies to the expenditure before the time of payment and, to the extent the amount of repayment is not subject to a reduction under new subsection 143.2(6), the expenditure is considered to have been made or incurred at the time of, and by the amount of, the repaid amount. Generally, this subsection applies after April 26, 1995.

Timing

ITA
143.2(10)

New subsection 143.2(10) of the Act provides that the payment of a limited-recourse amount results in the repaid amount being an expenditure made or incurred at the time of the payment. The former limited-recourse indebtedness is also considered to be a limited-recourse amount at all times before its repayment. To the extent the amount of the repayment is not subject to a reduction under new subsection 143.2(6), the expenditure is considered to have been made or incurred at the time of, and by the amount of, the repaid amount. This subsection applies after November 1994.

Short-Term Debt

ITA
143.2(11)

New subsection 143.2(11) provides an exception to the deemed "limited-recourse" rules in new subsections 143.2(7) and (8) where the otherwise affected indebtedness is fully repaid no later than 60 days after it arose, except where:

(a) any portion of the repayment is made with a "limited recourse amount", or

(b) the repayment is part of a series of loans or other indebtedness and repayments that ends more than 60 days after the indebtedness arose.

Generally, this subsection applies after November, 1994.

Series of Loans or Repayments

ITA
143.2(12)

New subsection 143.2(12) of the Act provides that, for the purpose of new paragraph 143.2(7)(a), a debtor is considered not to have made arrangements to repay an indebtedness within 10 years if the

arrangement to repay is part of a series of loans or other indebtedness and repayments that ends more than 10 years after it begins. Generally, this subsection applies after April 26, 1995.

Information Located Outside Canada

ITA
143.2(13)

New subsection 143.2(13) of the Act applies where information relevant in respect of indebtedness is located outside Canada, and the Minister of National Revenue is not satisfied that the indebtedness is not a limited-recourse amount. In such cases, the unpaid principal of the indebtedness shall be considered to be a limited-recourse amount unless:

- the information is provided to the Minister; or
- the information is located in a country with which Canada has a tax treaty that includes a provision under which the Minister can obtain the information.

This subsection applies after November 1994.

Information Located Outside Canada

ITA
143.2(14)

New subsection 143.2(14) of the Act applies where information relevant for the purpose of determining whether a taxpayer is not dealing at arm's length with another taxpayer is located outside Canada, and the Minister of National Revenue is not satisfied that the taxpayers are dealing at arm's length. In such cases, the taxpayers will be deemed not to be dealing with each other at arm's length unless:

- the information is provided to the Minister; or
- the information is located in a country with which Canada has a tax treaty that includes a provision under which the Minister can obtain the information.

This subsection applies after November 1994.

Assessments

ITA
143.2(15)

New subsection 143.2(15) of the Act provides to the Minister of National Revenue the authority to make the assessments, determinations and redeterminations that are necessary to give effect to section 143.2, notwithstanding that the taxation year in question is otherwise statute-barred from assessment. This subsection applies after November 1994.

Clause 95

Employees Profit Sharing Plans

ITA
144

Section 144 provides rules applicable to employees profit sharing plans.

Subclauses 95(1)

Employees Profit Sharing Plan

ITA
144(1)

Subsection 144(1) of the Act provides a definition of the term "employees profit sharing plan" for the purposes of section 144. This amendment to subparagraph 144(1)(a)(iii) of the English version of the Act replaces the reference to paragraphs (a) and (b), which was inadvertently included when the subparagraph was amended by the Statutes of Canada 1994, chapter 21 (Bill C-27), with the correct reference to subparagraphs (i) and (ii). This amendment applies

to the 1992 and subsequent taxation years, the same period to which the amendment in Bill C-27 applied.

Subclause 95(2)

Unused Portion of a Beneficiary's Exempt Capital Gains Balance

Subsection 144(1) is amended, applicable to the 1994 and subsequent taxation years, by adding the definition of "unused portion of a beneficiary's exempt capital gains balance" in respect of a trust governed by an employees profit sharing plan. The addition of this definition is consequential on the elimination of the $100,000 lifetime capital gains exemption for gains arising on dispositions that occur after February 22, 1994 and the introduction of the mechanism in subsection 110.6(19) for recognizing gains accrued to the end of that day.

This definition is relevant where a beneficiary of a trust governed by an employees profit sharing plan has an exempt capital gains balance in respect of the trust and the beneficiary receives property, other than money, in satisfaction of all or a portion of the beneficiary's interests in the trust. Property, other than money, received from the trust is received on the rollover basis set out in paragraphs 144(7.1)(a) and (b). Paragraph 144(7.1)(c) provides that an additional amount may be available to be included in the cost of property received from the trust in satisfaction of all or a portion of the beneficiary's interests in order that the beneficiary be able to make full use of an exempt capital gains balance in respect of the trust. This cost inclusion is also available in taxation years ending after 2004, even though exempt capital gains balances expire for such years, in order to be consistent with the adjusted cost base increase available under paragraph 53(1)(p) of the Act in respect of interests in flow-through entities. The total amount available to be included in the cost of properties received in satisfaction of all or a portion of the beneficiary's interests is the "unused portion of a beneficiary's exempt capital gains balance" in respect of a trust governed by an employees profit sharing plan. This defined amount equals, where the property is received before the end of the beneficiary's 2004 taxation year, the beneficiary's exempt capital gains balance in respect of the trust for the year minus the total of all reductions in capital gains in the year under section 39.1 of the Act due to the exempt capital gains balance. Where the property is received after the beneficiary's 2004

taxation year, this defined amount is the amount that would have been the exempt capital gains balance in respect of the trust for the beneficiary's taxation year minus any increase under paragraph 53(1)(p) in the adjusted cost base of an interest or a part of an interest of the beneficiary in the trust that was disposed of (other than in a disposition that is part of a transaction in which property was received from the trust in satisfaction of all or a portion of the beneficiary's interests in the trust). The unused portion of the beneficiary's exempt capital gains balance in respect of the trust governed by the employees profit sharing plan so determined is available to be allocated to the cost of each property received from the trust in the manner set out under paragraph 144(7.1)(c).

Subclause 95(3)

Where Property Other Than Money Received by Beneficiary

ITA
144(7.1)(b)

Paragraph 144(7.1)(b) is amended, applicable to the 1994 and subsequent taxation years, to permit an additional amount determined under new paragraph 144(7.1)(c) to be included in the cost of a property distributed to a beneficiary of an employees profit sharing plan by the trust in satisfaction of all or a portion of the beneficiary's interest in the trust.

Subclause 95(4)

Where Property Other Than Money Received By Beneficiary

ITA
144(7.1)(c)

New paragraph 144(7.1)(c) is added consequential on the elimination of the $100,000 lifetime capital gains exemption for gains arising on dispositions that occur after February 22, 1994 and the introduction of the mechanism in subsection 110.6(19) of the Act for recognizing gains accrued to that date. Where an individual recognizes a capital gain accrued to the end of that date on an interest in, or a share of the capital stock of, a flow-through entity (within the meaning assigned by subsection 39.1(1) of the Act), the amount of the gain is

credited to a special account referred to as the individual's exempt capital gains balance in respect of the entity. Claims may be made against this account to reduce gains that are flowed out to the individual by the entity for taxation years before 2005 and gains realized on dispositions of interests in or shares of the entity in those years.

An interest in a trust governed by an employees profit sharing plan is an interest in a flow-through entity on which a beneficiary of the trust may elect under subsection 110.6(19) and establish an exempt capital gains balance in respect of the trust. Distributions of property from the trust occur on the rollover basis set out in paragraphs 144(7.1)(a) and (b). This rollover does not permit the beneficiary to increase the cost of the property received to the extent of any unused exempt capital gains balance in respect of the trust. If the beneficiary ceases to have an interest in the trust, the beneficiary's exempt capital gains balance in respect of the trust is deemed to be nil for taxation years beginning after that time pursuant to subsection 39.1(7). In such circumstances, it is possible that the beneficiary may not have depleted the exempt capital gains balance in respect of the trust even though the property received from the trust had sufficient accrued gains to utilize all or a part of the undepleted exempt capital gains balance.

New paragraph 144(7.1)(c) is available to provide an addition to the cost to the beneficiary of each property determined under paragraph 144(7.1)(b). This cost inclusion is also available in taxation years ending after 2004, even though exempt capital gains balances expire for such years, in order to be consistent with the adjusted cost base increase available under paragraph 53(1)(p) in respect of interests in flow-through entities. The total amount available to be included under this new paragraph in the cost of properties received on a distribution in these circumstances is set out in the definition "the unused portion of a beneficiary's exempt capital gains balance" in respect of a trust governed by an employees profit sharing plan in subsection 144(1). In general, this defined amount is the extent to which a beneficiary of a trust governed by an employees profit sharing plan has not benefitted from his or her exempt capital gains balance in respect of the trust at a particular time. A beneficiary under an employees profit sharing plan who receives a distribution of property, other than money, in satisfaction of all or a portion of the beneficiary's interests in the trust may file an election with Revenue

Canada in respect of a particular property received to include a designated amount in the cost to the beneficiary of the property determined under paragraph 144(7.1)(b). The designated amount must not exceed the lesser of two amounts. The first amount is the unused portion of the beneficiary's exempt capital gains balance in respect of the trust minus the total of all other cost inclusions under paragraph 144(7.1)(c) in respect of a property received from the trust in the year. The second amount is the fair market value of the particular property minus the amount deemed to be the cost of the particular property under subparagraph 144(7.1)(b)(iv). Thus the cost of a property cannot be bumped to an amount higher than its fair market value. The election in respect of a property received by the beneficiary must be filed in prescribed form by the beneficiary's filing-due date for the taxation year in which the property was received.

New paragraph 144(7.1)(c) applies to the 1994 and subsequent taxation years. A prescribed form filed under paragraph 144(7.1)(c) before the end of the sixth month after the month that the bill that includes this amendment is assented to is deemed to be filed on time.

Clause 96

Registered Retirement Savings Plans

ITA
146

Section 146 of the Act provides rules governing the treatment of registered retirement savings plans (RRSPs).

Subclause 96(1)

ITA
146(1)

"annuitant"

An amendment was made to the English version of the definition "annuitant" in the Fifth Supplement of the Revised Statutes of Canada, 1985 to make that definition gender-neutral. This amendment

conforms the English version of the definition to the meaning of the expression before the Fifth Supplement changes became effective.

This amendment applies to taxation years that end after November 1991, as these are the taxation years to which the amendment made to the definition "annuitant" in the Fifth Supplement applied.

Subclause 96(2)

ITA
146(1)

"benefit"

Under subsection 146(8) of the Act, amounts received by taxpayers as benefits from RRSPs are included in computing income. Under the definition of "benefit" in subsection 146(1), certain amounts already included in computing income are not considered to be a "benefit".

The definition "benefit" is amended so that amounts received from a depositary RRSP that relate to interest or another amount that was credited or accrued after the end of the first calendar year commencing after the death of the annuitant are likewise excluded from the definition of "benefit", if such interest or other amount has been included in computing income otherwise that because of section 146.

This amendment applies to deaths occurring after 1992.

Subclause 96(3)

ITA
146(1)

"earned income"

The expression "earned income" is relevant for the purposes of determining the maximum deduction in respect of premiums under an RRSP. New paragraph (h) is added to the expression as a consequence of the amendments to subparagraph 14(1)(a)(v) of the Act. Paragraph (h), which applies to the 1995 and subsequent taxation

years, ensures that an amount determined under subparagraph 14(1)(a)(v) is not included in the determination of "earned income".

Subclause 96(4)

ITA
146(1)

"RRSP deduction limit"

The definition "RRSP deduction limit" is relevant in determining the maximum tax-deductible contributions that an individual may make in a year to RRSPs.

An individual's RRSP deduction limit for a year is determined in accordance with a formula set out in the definition. Amount B in the formula is the additional deduction room that becomes available to the individual in the year, based on earned income for the prior year and certain other factors.

The description of B is amended to clarify that amounts prescribed for the purpose of B are subtracted from the amount of additional deduction room that would otherwise become available. This amendment applies after 1988, which coincides with the introduction of the definition "RRSP deduction limit".

Subclause 96(5)

ITA
146(1)

"refund of premiums"

The definition "refund of premiums" is relevant for the purposes of determining the income inclusion for a deceased RRSP annuitant on death, the amount that is included in computing an RRSP beneficiary's income and the amount than can be transferred by a beneficiary on a tax-deferred basis under paragraph 60(l) of the Act.

This definition is amended to provide that a "refund of premiums" in respect of an RRSP does not include a "tax-paid amount" in respect

of the plan. As described in the commentary to that definition, a "tax-paid amount" in respect of an RRSP is an amount received in respect of RRSP income for a taxation year for which that income is not exempt from tax under Part I. Because of the existing wording in the definition "designated benefit" in subsection 146.3(1), the amendment also applies for the purposes of the rules for RRIFs.

This amendment applies to deaths occurring after 1992.

Subclause 96(6)

ITA
146(1)

"unused RRSP deduction room"

The definition "unused RRSP deduction room" measures the amount of deduction room for RRSP contributions that an individual may carry forward and use in future years.

An individual's unused deduction room for a year is the lesser of the amount determined under the formula in subparagraph (b)(i) of the definition and the limit in subparagraph (b)(ii). Amount B in the formula is the additional RRSP deduction room that becomes available to the individual in the year, based on earned income for the prior year and certain other factors.

The description of B is amended to clarify that amounts prescribed for the purpose of B are subtracted from the amount of additional deduction room that would otherwise become available. This amendment applies after 1988, which coincides with the introduction of the definition "unused RRSP deduction room".

Subclause 96(7)

ITA
146(1)

"tax-paid amount"

The definition "tax-paid amount" is added to subsection 146(1) of the Act. A "tax-paid amount" paid to a person in respect of an RRSP is,

in the case of a trusteed RRSP, an amount paid to the person in respect of the trust's income that is not exempt from tax under Part I because of paragraph 146(4)(c) of the Act. For this purpose RRSP income is computed without regard to subsection 104(6) of the Act. In the case of an RRSP that is a deposit, a "tax-paid amount" paid to the person in respect of the RRSP is an amount paid in respect of RRSP income that accrued or was credited after the end of the first calendar year beginning after the death of the RRSP annuitant. (Under paragraph 146(4)(c), RRSP trust income ceases to be exempt after the first calendar year that begins after the death of the RRSP annuitant. A similar rule for depositary RRSPs is provided under subsection 146(20).)

Under the definition "refund of premiums", a "tax-paid amount" does not qualify as a "refund of premiums". The definition is also relevant for the purposes of amended subsections 146(8.9) and 146.3(6.2), under which the income inclusion on death for RRSP and RRIF annuitants is determined.

This amendment applies to deaths occurring after 1992. The first "tax-paid amounts" can be received beginning in 1995 in respect of post-1994 income.

Subclause 96(8)

ITA
146(8.9)

Subsection 146(8.8) of the Act generally requires an amount to be included in computing the income of an RRSP annuitant on death. The amount is equal to the fair market value of the RRSP assets at the time of death. However, subsection 146(8.9) allows a deduction in computing such income. The maximum deduction is equal to a specified fraction of total refunds of premiums in respect of the plan. To the extent that less than the maximum deduction is claimed on behalf of the deceased annuitant, RRSP amounts can be distributed on a tax-free basis to RRSP beneficiaries.

Before the existing version of subsection 146(8.9) was introduced, an offset equal to the full amount of a "refund of premiums" was available under former paragraph 146(8.8)(b) or former subsection 146(8.9) and was applied to reduce the income inclusion

of the deceased annuitant. In cases where there were different classes of beneficiaries involved (e.g., a spouse and child sharing equally), this resulted in RRSP income that accrued after death and that was part of a "refund of premiums" being used inappropriately to reduce the income inclusion for the deceased annuitant.

Existing subsection 146(8.9) was designed to restrict the deduction available for the deceased in the above circumstances. The effect of subsection 146(8.9) is that the part of an RRSP "refund of premiums" that consists of post-death growth is ignored in calculating the offset available to the deceased RRSP annuitant. The restriction is designed to have an effect only where there are two different classes of RRSP beneficiaries, referred to below as "qualifying" and "non-qualifying" beneficiaries. A qualifying beneficiary includes a spouse of the deceased RRSP annuitant who receives a "refund of premiums" (including a spouse deemed by subsection 146(8.1) to receive a "refund of premiums" through the deceased's estate). A qualifying beneficiary also includes a dependent child or grandchild of the deceased annuitant who receives a "refund of premiums" or is deemed by subsection 146(8.1) to receive a "refund of premiums". A non-qualifying beneficiary is any other RRSP beneficiary, including the estate of the deceased annuitant to the extent that amounts received by the estate are not deemed by subsection 146(8.1) to be refunds of premiums.

The description of A in subsection 146(8.9) is amended so that the deduction under subsection 146(8.9) is based not only on refunds of premiums (including deemed refunds of premiums under subsection 146(8.1)), but also amounts that would have been refund of premiums (or could have been deemed refunds of premiums under subsection 146(8.1)) if it were not for the exclusion of "tax-paid amounts" from the determination of refunds of premiums. As described in the commentary on "refund of premiums" and "tax-paid amount", a tax-paid amount in respect of an RRSP is an amount received in respect of RRSP income for a taxation year for which that income is not exempt from tax under Part I.

This amendment applies to deaths occurring after 1992.

The following examples illustrate the application of subsection 146(8.9).

EXAMPLE 1

Mary died in 1993. Her unmatured trusteed RRSP at the time of her death was $100,000. It was worth $120,000 on January 1, 1995 and $125,000 at the time of its distribution in July 1996. Mary's widower John received the entire distribution.

Results:

1. *Mary's legal representatives are entitled to an offset of $100,000 against the income inclusion otherwise arising for Mary under subsection 146(8.8). Assuming the full offset is claimed, the income inclusion for John is equal to $125,000, of which $120,000 counts as a "refund of premiums" because the $5,000 paid out in respect of growth after 1995 is a "tax-paid amount". John is entitled to claim a deduction of $120,000 if it is transferred on a tax-deferred basis under paragraph 60(l).*

2. *More specifically, Mary's $100,000 offset under subsection 146(8.9) is determined as follows. First, add the amount of the "refund of premiums" ($120,000) paid to John and the "tax-paid amounts" (($5,000) paid to John. This total is multiplied by a fraction (4/5), which is derived from the formula (1 - (B + C - D)/(B + C) contained in subsection 146(8.9). In this example, the values of the variables in this formula are:*

   - *B is nil, as it will be in every case where nothing remains in an RRSP after the distribution of a "refund of premiums";*

   - *C is equal to $125,000, representing the total RRSP distributions; and*

   - *D is $100,000, representing the RRSP value at the time of death.*

EXAMPLE 2

Same as example 1, except that $70,000 was distributed to John and $55,000 was distributed to Mary's daughter, Karen.

Results:

1. *John is a 56% beneficiary and Karen is a 44% beneficiary of Mary's RRSP. Consequently, the "tax-paid amount" for John is equal to $2,800 (56% of $5,000) and the remaining $67,200 received by John counts as a "refund of premiums" that can be transferred by John under paragraph 60(l).*

2. *Mary's legal representatives are entitled to offset $56,000 against the $100,000 income inclusion otherwise arising for Mary under subsection 146(8.8). This offset is determined by multiplying the distributions made to John ($70,000) by the specified fraction (4/5), which is calculated in the same way as in Example 1.*

3. *Assuming the entire $56,000 offset is claimed by Mary's legal representatives, the income inclusion for Mary is equal to $44,000 ($100,000 - $56,000). As a consequence, Karen receives $44,000 of her $55,000 RRSP distribution on a tax-free basis, because the $44,000 received by Karen is not an RRSP "benefit" as defined in subsection 146(1).*

4. *In summary, $44,000 of the total $125,000 RRSP value at the time of distribution is included in computing Mary's income, $11,000 is included in computing Karen's income and the remaining $70,000 in included in computing John's income ($67,200 of which he can transfer on a tax-deferred basis under paragraph 60(l)).*

Clause 97

Registered Retirement Income Funds

ITA
146.3

Section 146.3 of the Act contains the rules governing registered retirement income funds (RRIFs).

Subclause 97(1)

ITA
146.3(2)(a)

Subsection 146.3(2) of the Act sets out the conditions that must be satisfied in order to register a retirement income fund.
Paragraph 146.3(2)(a) describes the payments that may be made out of a RRIF.

When the Statute Revision Commission revised the Act in the Fifth Supplement of the Revised Statues of Canada, 1985, the reference in paragraph 146.3(2)(a) to paragraph (1)(f), which defined the term "retirement income fund", was erroneously replaced with the term "retirement income" in the English version of the Act. This amendment corrects that error by adding the word "fund" to the term "retirement income". The amendment applies to taxation years that end after November 1991, as these are the taxation years to which the amendment which gave rise to the error applied.

Subclause 97(2)

ITA
146.3(5)

Under subsection 146.3(5) of the Act, amounts received by taxpayers from RRIFs are included in computing income, other than certain amounts already included in computing income.

Subsection 146.3(5) is amended so that amounts received from a depositary RRIF that relate to interest or another amount that accrued after the end of the first calendar year commencing after the death of

the annuitant are likewise not included in computing income under subsection 146.3(5), if such interest or other amount has been included in computing income otherwise than because of section 146.3.

This amendment applies to deaths occurring after 1992.

Subclause 97(3)

ITA
146.3(6.2)

Subsection 146.3(6) of the Act generally requires an amount to be included in computing the income of the last annuitant under a RRIF on death. The amount is equal to the fair market value of the RRIF assets at the time of death. However, subsection 146.3(6.2) allows a deduction in computing such income. The maximum deduction is equal to a specified percentage of total "designated benefits" in respect of the fund. To the extent that less than the maximum deduction is claimed on behalf of the deceased annuitant, RRIF amounts can be distributed on a tax-free basis to RRIF beneficiaries. As defined in subsection 146.3(1), "designated benefits" in respect of a RRIF are essentially amounts that would be "refunds of premiums" (or could be deemed to be "refunds of premiums" under subsection 146(8.1)) if the RRIF were an RRSP.

The description of A in subsection 146.3(6.2) is amended so that the deduction under subsection 146.3(6.2) in respect of a RRIF’s assets is based not only on designated benefits, but also on amounts that would be excluded from the definition of "designated benefits" because they would be "tax-paid amounts" if the RRIF were an RRSP. As described in the commentary on "refund of premiums" and "tax-paid amount", a "tax-paid amount" in respect of an RRSP is an amount included in income in respect of RRSP income for a taxation year for which the RRSP income is not exempt from tax under Part I. For further discussion, see the commentary on the amendment to subsection 146(8.9).

This amendment applies to deaths occurring after 1992.

Clause 98

Deferred Profit Sharing Plans

ITA
147(19)

Section 147 of the Act contains the rules governing deferred profit sharing plans (DPSPs). Subsection 147(19) provides for direct transfers of lump sum amounts between DPSPs and to DPSPs from other deferred income plans.

Subparagraph 147(19)(b)(ii) refers to "a spouse (within the meaning assigned by subsection 146(1.1))" of the Act. That subsection, which described spouses so as to include common-law spouses, was repealed with the enactment of subsection 252(4) of the Act, which also describes spouses so as to include common law spouses for the purposes of the Act. This amendment to subparagraph 147(19)(b)(ii), which applies after 1992, therefore deletes the reference to subsection 146(1.1) of the Act.

Clause 99

Registered Pension Plans - Deductibility of Contributions

ITA
147.2

Section 147.2 of the Act provides rules that govern the deductibility of employer and employee contributions to registered pension plans (RPPs).

Subclause 99(1)

ITA
147.2(2)(b)

Subsection 147.2(2) of the Act defines "eligible contributions" for the purpose of subsection 147.2(1), which provides for the deduction of employer contributions to RPPs. Under subsection 147.2(2), an employer contribution to a defined benefit provision of an RPP is an

eligible contribution where the contribution is made pursuant to the recommendation of an actuary, in whose opinion the contribution is required to fund the benefits provided under the provision, and the recommendation is approved by the Minister of National Revenue on the advice of the Superintendent of Financial Institutions.

Paragraph 147.2(2)(b) is amended to delete the requirement that the Minister obtain the advice of the Superintendent in order to approve an actuarial recommendation. This amendment, which applies after March 1996, is consequential on the transfer of the Pension Advice Section of the Office of the Superintendent of Financial Institutions to the Department of National Revenue.

Subclause 99(2)

ITA
147.2(4)(b)(iii)

Paragraph 147.2(4)(b) of the Act allows an individual to deduct past service contributions made to an RPP in respect of pre-1990 service when the individual was not an RPP contributor. The amount that may be deducted is subject to a cumulative limit imposed by subparagraph 147.2(4)(b)(iii). For the purpose of calculating the limit, past service additional voluntary contributions (AVCs) deducted under subparagraph 8(1)(m)(ii) are included in the amount Z in the formula in subparagraph 147.2(4)(b)(iii).

The description of Z is amended to refer to past service AVCs that were deducted in computing income for taxation years before 1987, and to refer to subparagraph 8(1)(m)(ii) as it read in the year in which the deductions were claimed. This amendment is made because subparagraph 8(1)(m)(ii) did not permit the deduction of past service AVCs after the 1986 taxation year.

This amendment applies to the 1991 and subsequent taxation years.

Subclause 99(3)

ITA
147.2(6)

Paragraphs 147.2(4)(b) and (c) of the Act allow a taxpayer to deduct, within limits, contributions made to an RPP in respect of service before 1990.

Paragraph 147.2(4)(b) allows a taxpayer to deduct contributions in respect of pre-1990 service during which the taxpayer was not a contributor to an RPP. It limits the deduction in any given year to $3,500, and limits the cumulative amount that can be deducted to $3,500 times the number of years of such service.

Paragraph 147.2(4)(c) allows a taxpayer to deduct contributions in respect of pre-1990 service during which the taxpayer was an RPP contributor. It limits the deduction in any given year to $3,500 minus other RPP contributions deducted in the year, but imposes no cumulative limit on the amount that can be deducted.

Both paragraphs allow contributions that are not deducted in one year to be carried forward and deducted in a subsequent year, subject to the relevant limits.

New subsection 147.2(6) modifies paragraphs 147.2(4)(b) and (c) for the year in which a taxpayer dies and for the preceding year. It provides that, in determining the amounts that can be deducted under those paragraphs for those years, the $3,500 annual limits are disregarded. Subsection 147.2(6) does not change the cumulative limit on deductions under paragraph 147.2(4)(b).

This amendment, which applies to taxpayers who die after 1992, ensures that RPP contributions which a taxpayer was unable to deduct prior to death – because of the $3,500 annual limits – can generally be deducted on death.

Clause 100

Eligible Funeral Arrangements

ITA
148.1(1) and (2)

Section 148.1 of the Act, in conjunction with paragraph 149(1)(s.1) provides for the tax-free build-up of income earned on contributions made under an "eligible funeral arrangement". The contribution limit under the existing law is $15,000 per arrangement.

The expression "cemetery care trust" is introduced in subsection 148.1(1). It is defined as a trust established pursuant to an Act of a province for the care and maintenance of a cemetery. (Such trusts are sometimes known as perpetual care funds.) New paragraph 149(1)(s.2) ensures that income earned in a cemetery care trust is expressly exempt from taxation. However, under the definition "eligible funeral arrangement", contributions to such trusts are relevant for the purposes of determining whether an arrangement with a cemetery operator is considered to be an "eligible funeral arrangement". If an arrangement with a cemetery operator is not an "eligible funeral arrangement", any income earned under a pre-needs cemetery contract that is part of such an arrangement would be subject to taxation.

The definition "eligible funeral arrangement" is amended so that the contribution limit for an arrangement that only covers "cemetery services" is $20,000, rather than $15,000. "Cemetery services" is defined as property and services that relate directly to cemetery arrangements in Canada, including property and services to be funded out of a cemetery care trust. (However, the postamble to the definition "eligible funeral arrangement" ensures that payments made for the immediate acquisition of burial rights or of any interest in a building or structure for the placement of human remains is ignored for the purposes of the contribution limit, to the extent that such payments are not applied as a contribution to a cemetery care trust.)

The definition "eligible funeral arrangement" is also amended so that the contribution limit for an arrangement that combines funeral and cemetery arrangements is $35,000. This amendment is necessary

because, in some provinces, funeral and cemetery services can be provided by the same operator.

The definition "funeral services" is amended so that "cemetery services" are no longer included within the definition. The existing definition "funeral services" is effectively replaced within subsections 148.1(1) and (2) by the new definition "funeral or cemetery services", which is defined as "funeral services" or "cemetery services" with respect to an individual, or any combination of such services. The definitions "custodian", "qualifying person" and "relevant contribution" in subsection 148.1(1) are also amended, strictly as a consequence of the new definition "funeral or cemetery services".

These amendments apply to the 1993 and subsequent taxation years.

ITA
148.1(3)

Subsection 148.1(3) of the Act provides for an income inclusion in the event that there is return of funds from an eligible funeral arrangement. It is amended so that, for this purpose, any transactions with, or balances under, a cemetery care trust are ignored. As cemetery care trusts are irrevocable under provincial law, it is not necessary that growth under such trusts be considered for the purposes of this subsection.

This amendment applies to the 1993 and subsequent taxation years.

Clause 101

Exemptions from Tax

ITA
149

Section 149 of the Act exempts certain taxpayers from tax under Part I of the Act and provides special rules for such taxpayers.

Subclause 101(1)

ITA
149(1)(o.1)

Paragraph 149(1)(o.1) of the Act provides an exemption from tax under Part I of the Act for corporations incorporated and operated solely for the administration of a registered pension plan, where the corporation has been accepted by the Minister of National Revenue as a funding medium for the purposes of the registration of a pension plan.

Paragraph 149(1)(o.1) is amended, applicable to the 1994 and subsequent taxation years, to provide that such corporations may also act as trustees and administrators of trusts governed by retirement compensation arrangements, where those arrangements provide for benefits supplementary to those provided under the registered pension plan.

Subclause 101(2)

ITA
149(1)(s.2)

New paragraph 149(1)(s.2) of the Act provides that a "cemetery care trust", as defined by subsection 148.1(1), is exempt from tax under Part I of the Act on its taxable income. For further detail, see the commentary on subsection 148.1(1).

This amendment applies to the 1993 and subsequent taxation years.

Subclauses 101(3) and (4)

ITA
149(10)

Subsection 149(10) of the Act sets out the tax treatment of a corporation that either becomes or ceases to be exempt from tax under Part I of the Act (otherwise than because of paragraph 149(1)(t), which exempts certain farmers' and fishers' insurers). In broad terms, subsection 149(10) provides for:

- a year-end;
- the mandatory deduction of available reserves;
- the fair market value disposition and reacquisition of the corporation's property;
- the preservation of latent recapture on depreciable property; and
- a limitation on loss carry-forwards.

The principle underlying subsection 149(10) is that where a corporation's tax status changes, it ought to be treated more or less as though it had begun a new existence. This amendment applies that "fresh start" principle more comprehensively, drawing a clearer line between a corporation's tax position before it becomes or ceases to be exempt, and its position once that has happened. This is accomplished chiefly by broadening the deemed disposition and reacquisition rule in paragraph 149(10)(b) and by substantially reworking the portion of the subsection that follows that paragraph.

Paragraph 149(10)(a) is amended to allow a corporation that becomes or ceases to be exempt to establish a new fiscal period for taxation years that begin after that change in its status.

The deemed disposition and reacquisition rules in paragraph 149(10)(b) are made more complete by deleting the existing exception for the resource properties of a corporation that ceases to be exempt. A corporation will be treated as having disposed of all of its property for proceeds equal to its fair market value, at the "disposition time" – that is, the time immediately before the time immediately before it becomes or ceases to be exempt.

Next, the amendment replaces existing paragraphs 149(10)(c) and (d). Paragraph 149(10)(c) currently applies where the corporation's capital cost of a depreciable property exceeds the property's fair market value. To ensure that on a later disposition of the property the corporation is subject to the recapture of any excess capital cost allowance it claimed before its status changed, the paragraph preserves the property's capital cost, and treats the excess as having been allowed as capital cost allowance. In keeping with the more complete separation between the tax history of a corporation

before its status changes and its treatment afterwards, this rule is deleted.

New paragraph 149(10)(c), which is unrelated to the existing provision, provides that a corporation that becomes or ceases to be exempt from tax is to be treated for certain purposes of the Act as a new corporation the first taxation year of which began with its change in status. Those purposes include: the scientific research and experimental development deduction and credit under sections 37 and 127.3, the resource property rules in sections 65 to 66.4 and 66.7, loss carryovers under section 111, foreign tax credits under section 126, and investment tax credits under subsections 127(5) to (12.3). New paragraph 149(10)(c) thus precludes a corporation whose tax status changes from subsequently using any of the listed deductions and credits it may have accumulated before the change, and vice versa.

Existing paragraph 149(10)(d) limits a corporation's use of losses incurred before its tax status changed. Since new paragraph 149(10)(c) denies any carryover of losses across a change in status, existing paragraph (d) is superfluous. It is replaced with a rule requiring the corporation to realize any latent loss in respect of its cumulative eligible capital (CEC). Where, immediately before the disposition time, the corporation's CEC in respect of a business exceeds the total of 3/4 of the fair market value of the business's eligible capital property and the CEC amount otherwise deducted under paragraph 20(1)(b) of the Act for the corporation's last taxation year before its tax status changes, the excess is to be deducted in computing the corporation's income for that year.

These changes to subsection 149(10) apply where a corporation becomes or ceases to be exempt from tax under Part I of the Act after April 26, 1995.

Subclause 101(5)

ITA
149(11)

Subsection 149(11) of the Act provides that subsection 149(10) of the Act does not apply to a corporation that becomes or ceases to be

exempt from tax because its control is acquired, if the acquisition of control takes place pursuant to an agreement in writing entered into on or before November 12, 1981. With the passage of time, this transitional rule has become redundant. The subsection is repealed on Royal Assent to this legislation.

Clause 102

Charities - Disbursement Quota

ITA
149.1(1)

Section 149.1 of the Act contains rules relating to registered charities. Definitions for purposes of these rules are found in subsection 149.1(1).

The definition "disbursement quota" in subsection 149.1(1) means an amount determined by a formula which requires that a charity spend a specified proportion of donations for which tax receipts are issued, and in the case of charitable foundations a specified percentage of the value of investment assets, on charitable activities or gifts to other charities.

This formula was introduced by the Statute Revision Commission in the Fifth Supplement of the Revised Statutes of Canada, 1985, to replace the then-existing narrative description of the disbursement quota. The formula erroneously departed from the underlying structure of the disbursement quota, by failing to properly account for the mathematical relationship between gifts received by a charitable foundation and the amount that such a foundation is required to disburse. This amendment to the definition, which generally applies to taxation years that end after November 1991, restores the correct relationship between these two factors.

Clause 103

Assessments

ITA
152

Section 152 of the Act contains rules relating to assessments and reassessments of tax, interest and penalties payable by a taxpayer and to determinations and redeterminations of amounts of tax deemed to have been paid by a taxpayer.

Subclause 103(1)

ITA
152(1.2)

Subsection 152(1.2) of the Act provides for the application of paragraphs 56(1)(l) and 60(o) and Divisions I and J as they relate to assessments and to various determinations and redeterminations made under Part I of the Act. An exception is made, however, to ensure that subsections 152(1) and (2) do not apply to determinations made under subsections 152(1.1) and (1.11).

This amendment to subsection 152(1.2) provides for a new exception: subsection 164(4.1) will not apply in respect of determinations and redeterminations made under new subsection 152(1.4), which deals with partnerships. (For further information, reference may be made to the commentary on that provision.) Therefore, where a Court, on the disposition of an appeal of a determination or redetermination in respect of a partnership, orders the Minister of National Revenue to make a redetermination, the Minister will have discretion not to make the redetermination or to refund any resulting overpayment immediately, but to wait until all rights of appeal have expired.

The amendment applies to determinations made after Royal Assent.

Subclause 103(2)

ITA
152(1.4) to (1.8)

New subsections 152(1.4) to (1.8) of the Act provide rules to deal with partnerships. These new subsections apply to determinations made after Royal Assent.

Determination in Respect of a Partnership

ITA
152(1.4)

New subsection 152(1.4) of the Act provides the Minister of National Revenue with the authority to determine any income or loss of a partnership for a fiscal period within three years after the later of the day on which an information return in respect of the partnership for the fiscal period is required to be filed under section 229 of the *Income Tax Regulations* and the day on which the return is actually filed. This determination is made at the partnership level. The Minister will also have the authority to determine any deduction, amount or matter at the partnership level that is considered relevant in determining the tax liability of, and various amounts payable by, or refundable to, the members of the partnership under the Act for any taxation year.

Notice of Determination

ITA
152(1.5)

Under new subsection 152(1.5) of the Act, the Minister of National Revenue must send a notice of the determination made under subsection 152(1.4) in respect of the fiscal period of a partnership to the partnership as well as to each person who was, during that fiscal period, a member of the partnership.

Absence of Notification

ITA
152(1.6)

New subsection 152(1.6) of the Act clarifies that a determination made under subsection 152(1.4) in respect of a partnership will still be valid even though one or more members of the partnership do not receive a notice of the determination. This could happen, for example, where the address of a member changed since the last filing of the partnership return under section 229 of the *Income Tax Regulations*.

Binding Effect of Determination

ITA
152(1.7)

New subsection 152(1.7) of the Act provides that a determination or redetermination made by the Minister of National Revenue in respect of a partnership under subsection 152(1.4) is binding on the Minister and all the members of the partnership in spite of the fact that the determination or redetermination was made at the partnership level. The Minister will then have one year after the expiration of the right to object or to appeal of a designated member of the partnership, as provided under new subsection 165(1.15), to assess the tax liability of, or to determine any amount deemed to have been paid or to have been an overpayment by, any member of the partnership and any other affected taxpayer (such as a member's spouse). Such assessment or determination can only be made to the extent that it is necessary to give effect to the determination or redetermination that was previously made at the partnership level or to a decision of a court in respect of that determination or redetermination.

Time to Assess

ITA
152(1.8)

New subsection 152(1.8) of the Act will come into play where the Minister of National Revenue makes a determination at the partnership level but it is subsequently demonstrated that there is no partnership or that a taxpayer in respect of which an assessment or

determination was made on the basis that the taxpayer was a member of the partnership is not, in fact, a member of the partnership. In such cases, the one year time limit for the Minister to assess the tax liability of, or to determine any amount deemed to have been paid or to have been an overpayment by, any taxpayer will start not after the day on which all rights of objection and appeal in respect of the determination made at the partnership level expired or are determined (as it would otherwise be under new paragraph 152(1.7)(b)), but after the day where it is demonstrated that there is no partnership or that the taxpayer is not a member of the partnership.

The authority for the Minister to make an assessment or determination under subsection 152(1.8) is restricted to the extent that the assessment or determination must be related to the same issues that triggered the making of a determination at the partnership level under subsection 152(1.4) and to the finding that no partnership existed or that the taxpayer is not a member of the partnership.

Subclause 103(3)

ITA
152(3.1)

The time within which the Minister of National Revenue may generally reassess is known as the "normal reassessment period", as defined by subsection 152(3.1) of the Act. More specifically, the normal reassessment period is the 3 or 4-year period beginning after the day of mailing of a notice of an original assessment for a taxation year or the day of mailing of a notification that no tax is payable for the year. Subsection 152(3.1) is amended so that the definition of normal reassessment period applies for the purpose of new subsection 152(4.01). That provision limits the matters in respect of which the Minister can reassess, where a reassessment to which paragraph 152(4)(a) or (b) applies is made beyond the normal reassessment period for a taxpayer in respect of a taxation year. A similar limitation was previously found in subsections 152(4) and (5). Subsection 152(3.1) is also amended to clarify that the normal reassessment period begins to run from the time that is the earlier of the day of mailing of an original assessment and the day of mailing of a notification that no tax is payable. Subsection 152(3.1) applies after April 27, 1989.

Subclause 103(4)

ITA
152(4)

In general terms, subsection 152(4) of the Act provides that the Minister of National Revenue may not reassess tax payable by a taxpayer for a taxation year after the normal reassessment period for the taxpayer in respect of the year unless certain conditions described in paragraph 152(4)(a) or (b) have been met. More specifically, paragraph 152(4)(a) provides that the Minister may reassess at any time in cases of misrepresentation or fraud or where a waiver has been filed within the normal reassessment period for the taxpayer in respect of the year. Paragraph 152(4)(b) allows the Minister to reassess a taxpayer within 3 years after the end of the normal reassessment period for the taxpayer in respect of the year, where the reassessment is required because of an adjustment described in subsection 152(6), such as the carryback of a loss, or is made as a consequence of certain other matters described in that paragraph. Subsection 152(4) is amended as a consequence of the addition of new subsection 152(4.01). That provision limits the matters in respect of which the Minister may reassess, where a reassessment to which paragraph 152(4)(a) or (b) applies is made beyond the normal reassessment period for a taxpayer in respect of a taxation year. A similar limitation was previously found in subsections 152(4) and (5). New subsection 152(4) applies after April 27, 1989.

ITA
152(4.01)

New subsection 152(4.01) of the Act limits the matters in respect of which the Minister of National Revenue can reassess, where a reassessment to which paragraph 152(4)(a) or (b) applies is made beyond the normal reassessment period for a taxpayer in respect of a taxation year. In general terms, such a reassessment can be made only to the extent that it can reasonably be regarded as relating to a misrepresentation, fraud or waiver, or a matter specified in any of subparagraphs 152(4)(b)(i) to (iv), because of which the Minister is able to reassess beyond the normal reassessment period. This limitation replaces similar ones in subsections 152(4) and (5) of the existing Act. New subsection 152(4.01) applies after April 27, 1989.

Subclause 103(5)

ITA
152(5)

Subsection 152(5) of the Act provides that where the Minister of National Revenue reassesses a taxpayer's tax for a taxation year beyond the normal reassessment period for the taxpayer in respect of the year in a case of fraud or misrepresentation or on the authority of a waiver filed by the taxpayer, the reassessment shall not include in income any amount not previously included in respect of which the taxpayer did not commit a fraud or misrepresentation or that does not relate to a matter specified in the waiver. Subsection 152(5) is amended as a consequence of the addition of new subsection 152(4.01). New subsection 152(4.01) will henceforth limit the matters in respect of which the Minister may reassess, where a reassessment to which paragraph 152(4)(a) or (b) applies is made beyond the normal reassessment period for a taxpayer in respect of a taxation year. Subsection 152(5) will, however, continue to circumscribe the Minister's power to reassess beyond the normal reassessment period where, for example, a reassessment is made pursuant to subsection 165(3) as a consequence of an objection filed by a taxpayer to a notice of assessment. This amendment applies after April 27, 1989.

Subclause 103(6)

ITA
152(6)

Subsection 152(6) of the Act provides for the reassessment of tax payable for a taxation year where a deduction or credit is being claimed as the result of a carryback from a subsequent taxation year.

The subsection is amended to require the Minister of National Revenue to reassess a deceased taxpayer's return for the year prior to the year of death where a deduction is claimed for that prior year under subsection 147.2(4) of the Act as modified by new subsection 147.2(6).

Subsection 147.2(4) allows a deduction for contributions to a registered pension plan, subject to certain limits where the

contributions are in respect of service before 1990.
Subsection 147.2(6) relaxes these limits for the year in which the taxpayer dies and for the preceding year.

This amendment to subsection 152(6) applies to taxpayers who die after 1992.

Clause 104

Withholding of Tax

ITA
153(1)

Section 153 of the Act contains rules relating to the withholding of tax from certain payments and its remittance to the Receiver General. Subsection 153(1) lists those payments from which tax must be withheld. This amendment to subsection 153(1) adds to that list amounts in respect of employment earnings supplements, which are dealt with in new paragraph 56(1)(r) of the Act. This amendment applies to payments made after 1992.

Clause 105

Instalment Payments - "net tax owing"

ITA
156.1(1)

Subsection 156.1(1) of the Act sets out definitions that are relevant for the purpose of the instalment rules. The postamble of the definition "net tax owing" is amended, as a result of the amendment to subsection 161(7) of the Act, to clarify that income taxes payable by an individual are determined before taking into consideration the consequences of the deduction or exclusion of an amount referred to in paragraph 161(7)(a). This amendment applies to amounts that become payable after December 1995.

Clause 106

Instalment Payments - Corporations

ITA
157

Section 157 of the Act sets out the required payment dates for corporate income tax instalments and for any balance of corporate income tax payable.

Subclause 106(1)

ITA
157(2)(c)

Subsection 157(2) of the Act sets out conditions under which a co-operative corporation or a credit union is permitted to make only one payment of the whole of its tax payable for a taxation year, rather than having to make instalments. Paragraph (c) is amended, as a result of the amendment to subsection 161(7), to clarify that taxable income, for the purposes of the threshold, is to be computed before taking into consideration the consequences of the deduction or exclusion of an amount referred to in paragraph 161(7)(a). This amendment applies to amounts that become payable after December 1995.

Subclause 106(2)

ITA
157(2.1)

Subsection 157(2.1) of the Act provides that where a corporation's tax payable or its first instalment base for the year is less than $1,000, the corporation is exempt from the requirement to make instalment payments. Paragraph 157(2.1)(a) is amended, as a result of the amendment to subsection 161(7) of the Act, to clarify that taxes payable by a corporation for a taxation year is to be computed before taking into consideration the consequences of the deduction or exclusion of an amount referred to in paragraph 161(7)(a). This amendment applies to amounts that become payable after December 1995.

Subclause 106(3)

ITA
157(3)

Subsection 157(3) of the Act provides a reduction of the amount to be paid by instalments of tax for a year by certain corporations where they are entitled to claim amounts deemed by the Act to have been paid on account of their taxes for the year. This subsection is amended to add new paragraph 157(3)(e) which will allow the reduction of instalments to take into consideration the deemed payment under subsection 127.1(1) of the Act in respect of the taxpayer's refundable investment tax credit for the year. This amendment applies to taxation years that end after February 22, 1994.

Clause 107

Tax Liability - Non-arm's Length Transfers of Property

ITA
160

Section 160 of the Act imposes joint and several liability for tax on certain transfers of property between individuals who do not deal at arm's length with each other.

Subclause 107(1)

ITA
160(1.1)

New subsection 160(1.1) of the Act provides that where subsection 69(11) of the Act applies to deem a disposition of property to have occurred at fair market value, both the person disposing of the property and the person acquiring the property are jointly and severally liable for the payment of each other's liabilities arising under the Act as a result of that disposition. Essentially, each person's liability for any taxation year affected by the disposition is the excess of the amount payable under the Act by that person for that year over the amount that would have been payable by that person for that year had subsection 69(11) not applied

to the disposition. New subsection 160(1.1) of the Act applies to dispositions deemed by subsection 69(11) to have occurred after April 26, 1995.

Subclause 107(2)

ITA
160(2) and (3)

Subsections 160(2) and (3) of the Act set out rules for the assessment, payment and extinguishment of the joint and several liabilities arising under subsection 160(1) of the Act. These subsections are replaced with new subsections 160(2) and (3) of the Act, which apply both to subsection 160(1) and new subsection 160(1.1) and continue to apply to the assessment, payment and extinguishment of the liabilities arising under these subsections. New subsection 160(2) allows the Minister to assess a taxpayer at any time in respect of liabilities arising under section 160 and such an assessment will have the same effect as if it had been made under section 152. New subsection 160(3) provides that where a particular taxpayer becomes jointly and severally liable with another taxpayer under subsection 160(1) or (1.1) with respect to a tax liability of the other person, a payment by the particular taxpayer on account of the particular taxpayer's tax liability will discharge the joint liability to the extent of the payment. However, a payment by the other taxpayer on account of the other taxpayer's tax liability, will reduce the particular taxpayer's liability only to the extent that the total tax liability of the other taxpayer is reduced below the amount of the joint and several liability. New subsections 160(2) and (3) of the Act apply on Royal Assent.

Clause 108

Interest

ITA
161

Section 161 of the Act provides for the payment of interest on outstanding amounts of tax payable under Part I, as well as on late or deficient instalments in respect of such tax.

Subclauses 108(1) to (4)

ITA
161(7)

Subsection 161(7) of the Act provides that, where the amount of tax payable for a taxation year is reduced because of certain deductions or exclusions arising from the carryback of losses or tax credits or from events in subsequent years, interest on any unpaid tax for the taxation year is calculated without regard to the reduction until the latest of several dates.

Paragraph 161(7)(a) is amended to include in the list of deductions and exclusions a deduction claimed under subsection 147.2(4), as modified by new subsection 147.2(6), because of the death of the taxpayer in the subsequent year. Subsection 147.2(4) allows a deduction for contributions to a registered pension plan, subject to certain limits where the contributions are in respect of service before 1990. Subsection 147.2(6) relaxes these limits for the year in which the taxpayer dies and for the preceding year. This amendment to paragraph 161(7)(a) applies to taxpayers who die after 1992.

Paragraph 161(7)(a) is further amended to clarify that the consequences of the deduction or exclusion of an amount referred to in the subparagraphs that follow must not be taken into consideration in the determination of taxes payable by a taxpayer for the taxation year. Paragraph 161(7)(b) is also amended as a result of the wording change in paragraph (a). These amendments apply to amounts that become payable after December 1995.

Subclause 108(5)

ITA
161(11)

Subsection 161(11) of the Act requires the payment of interest on penalties imposed under the Act. Subsection 161(11) is amended to add new paragraph (b.1) which applies in the case of a penalty payable under new subsection 237.1(7.4) of the Act. New subsection 237.1(7.4) is analogous to repealed subsection 162(9), which provides a penalty where a person fails to comply with the reporting requirements in respect of tax shelters under section 237.1.

This amendment applies after December 1, 1994.

Subclause 108(6)

ITA
161(12)

New subsection 161(12) of the Act allows the interest on a penalty under new subsection 237.1(7.4) of the Act to be assessed against a partnership and applies the provisions of the Act relating to assessments, payments and appeals with respect to interest on those penalties as if the partnership were a corporation. This subsection applies after December 1, 1994.

Clause 109

Penalties - Tax Shelters

ITA
162(9)

Subsection 162(9) of the Act imposes a penalty for failure to comply with the reporting requirements in respect of tax shelters in section 237.1. The repeal of subsection 162(9), applicable after December 1, 1994, is consequential on the introduction of new subsection 237.1(7.4) of the Act.

Clause 110

Penalties

ITA
163

Section 163 imposes penalities in respect of serious failures to comply with the Act, such as making false statements or omitting to report income.

Subclause 110(1)

ITA
163(2)

Subsection 163(2) of the Act imposes a penalty where a taxpayer knowingly, or in circumstances amounting to gross negligence, participates in or makes a false statement for the purposes of the Act.

Subsection 163(2) is amended to clarify that taxpayers who volunteer false information for the purposes of the Act are liable to a penalty.

This amendment applies after ANNOUNCEMENT DATE.

Subclause 110(2)

ITA
163(4)

Subsection 163(2) of the Act imposes a penalty where a taxpayer, knowingly or through gross negligence, understates income for a taxation year. Subsection 163(4) clarifies that, in determining the understatement of income, certain deductions and exclusions arising from events in subsequent years are disregarded.

Subsection 163(4) is amended to include in the list of deductions and exclusions to be disregarded a deduction claimed under subsection 147.2(4) of the Act, as modified by new subsection 147.2(6), because of the death of the taxpayer in the subsequent year. Subsection 147.2(4) allows a deduction for contributions to a registered pension plan, subject to certain limits where the contributions are in respect of service before 1990. Subsection 147.2(6) relaxes these limits for the year in which the taxpayer dies and for the preceding year.

This amendment to subsection 163(4) applies to taxpayers who die after 1992.

Clause 111

Refunds

ITA
164

Section 164 of the Act contains rules relating to refunds of taxes, including provisions dealing with repayments, application to other debts, and interest.

Subclause 111(1)

ITA
164(1)(*a*)(i)

Subsection 164(1) of the Act provides rules governing refunds of overpayments of tax.

Subparagraph 164(1)(*a*)(i) is amended to correct the references to elements of the definition "refundable investment tax credit" in subsection 127.1(2) consequential on the amendments to that definition which apply to taxation years that end after December 2, 1992.

This amendment applies to taxation years that end after December 2, 1992.

Subclause 111(2)

ITA
164(1)(b)

If a taxpayer has filed the tax return for a taxation year within 3 years from the end of the year, the Minister of National Revenue may refund any overpayment of tax for the year. Where no such refund is made, paragraph 164(1)(b) of the Act allows the taxpayer to make an application for the refund within the period determined under paragraph 152(4)(b) or (c) within which the Minister may reassess tax payable by the taxpayer for the year. The amendments to paragraph 164(1)(b) are strictly consequential on the amendments to

subsection 152(4) and effect no substantive changes to this provision. Amended paragraph 164(1)(b) applies after April 27, 1989.

Subclause 111(3)

ITA
164(2.1)

Subsection 164(2) of the Act provides that, where a taxpayer is liable or about to become liable for other income tax payments, the Minister may apply the amount of an overpayment to the other tax liability rather than make a refund. Subsection 164(2.1) provides for such an offset in the case of Goods and Services Tax credit payments. Subsection 164(2.1) is amended so that, when the applicable return is filed on time, the offset occurs on the day the amount would have been paid to the individual if the offset had not occurred. When the individual's return for the year is not filed on time, the offset occurs on the day the amount is actually applied. This amendment applies on Royal Assent.

Subclauses 111(4) and (5)

ITA
164(5) and (5.1)

Subsection 164(5) of the Act provides that, where the tax payable for a taxation year is reduced because of certain deductions or exclusions arising from the carryback of losses or tax credits or from events in subsequent years, interest payable to a taxpayer on any resulting overpayment of tax is to be calculated as if the overpayment had arisen on the latest of several dates.

Subsection 164(5) is amended to include in the list of deductions and exclusions a deduction claimed under subsection 147.2(4) of the Act, as modified by new subsection 147.2(6), because of the death of the taxpayer in the subsequent year. Subsection 147.2(4) allows a deduction for contributions to a registered pension plan, subject to certain limits where the contributions are in respect of service before 1990. Subsection 147.2(6) relaxes these limits for the year in which the taxpayer dies and for the preceding year.

Subsection 164(5.1), which deals with interest payable in the case of a repayment of an amount in dispute, contains a rule analogous to that in subsection 164(5). The amendment to subsection 164(5.1) is similar to the amendment to subsection 164(5).

The amendments to subsections 164(5) and (5.1) apply to taxpayers who die after 1992.

Subclause 111(6)

ITA
164(6)(c)

Subsection 164(6) allows a deceased taxpayer's legal representative to elect to treat certain capital losses or terminal losses of the taxpayer's estate for its first taxation year as capital losses or terminal losses of the taxpayer for the taxpayer's last taxation year. Under paragraph 164(6)(c) the election is limited to the amount by which the estate's capital losses exceed its capital gains for that year.

Paragraph 164(6)(c) is amended to ensure that subsection 112(3) does not apply to reduce a deceased taxpayer's loss which was transferred under that paragraph.

This amendment applies to deaths that occur after 1993.

Clause 112

Transitional Provision

Subsection 164(6) of the Act allows a deceased taxpayer's legal representative to elect to treat certain capital losses of the taxpayer's estate for its first taxation year to be capital losses of the taxpayer's last taxation year. Under paragraph 164(6)(c) the election must be made within a prescribed time and under paragraph 164(6)(e) the legal representative must file an amended return of income for the deceased taxpayer's last taxation year within the time prescribed for the election.

This transitional rule will provide a limited opportunity for an estate to transfer a capital loss arising from the disposition of a share of the

capital stock of a corporation to the taxpayer's last taxation year even though the election was not made within the prescribed time, or the disposition occurred after the end of the estate's first taxation year. For this rule to apply, the estate's first taxation year must have ended after April 26, 1995 and before 1997 and the loss in respect of the share must have arisen from a disposition occurring before 1997. In conjunction with the coming-into-force provisions for the amended stop-loss rules in subsections 112(3) to (3.32) of the Act, the capital loss that can be transferred under subsection 164(4) by an estate will not be reduced by the tax-free dividends received by the estate on the share.

The transitional rule is applicable where the legal representative files a written election with the Minister of National Revenue within six months after the month in which this Act receives Royal Assent. Where a valid election is filed, the timing requirements under paragraphs 164(6)(c) and (e) will be considered fulfilled provided that the paragraph 164(6)(c) election and the amended return referred to in paragraph 164(6)(e) are filed within the time allowed for the election above.

Clause 113

Objections to Assessments

ITA
165

Section 165 of the Act provides rules governing a taxpayer's right to object to an assessment or determination by the Minister of National Revenue of tax, interest, penalties and certain other amounts.

Subclauses 113(1) and (2)

ITA
165(1.1)

Where the Minister of National Revenue has issued a notice of assessment or determination, subsection 165(1.1) of the Act restricts, in certain cases, the matters to which a taxpayer may object to those matters which gave rise to the assessment or redetermination. The

amendments to subsection 165(1.1) are consequential to the introduction of subsection 152(1.8) of the Act, which allows the Minister to assess the tax liability of, or to determine any amount deemed to have been paid or to have been an overpayment by, a taxpayer who was believed to be a member of a partnership or any other affected persons. Such an assessment or determination may only be made to give effect to a determination made under subsection 152(1.4) in respect of the entity that was believed to be a partnership.

The right of a taxpayer who was believed to be a member of a partnership to object to an assessment or determination made in respect of that partnership under new subsection 152(1.8) will be restricted to the matters that were relevant in the making of a determination at the partnership level or that result from the finding that the taxpayer is not a member of the partnership or that there is no such partnership.

These amendments apply to determinations made after Royal Assent.

Subclause 113(3)

ITA
165(1.15)

New subsection 165(1.15) of the Act provides that only the member of a partnership designated by all the members of the partnership in the partnership return filed annually under section 229 of the *Income Tax Regulations* can exercise the right to object to a determination made by the Minister of National Revenue under new subsection 152(1.4) of the Act. For that purpose, the Minister will request the members of a partnership to indicate, in the partnership return, the name and address of the member that has been designated by the partnership and its members as representative of the partnership. Only one person may be so named. If no member has been so designated, the authority to initiate legal proceedings is vested in any member expressly authorized to act on behalf of the partnership in respect of the proceedings.

New subsection 165(1.15) applies to determinations made after Royal Assent.

Subclause 113(4)

ITA
165(3.1) and (3.2)

Subsections 165(3.1) and (3.2) of the Act deal with referrals to the Minister of National Health and Welfare of notices of objections to determinations relating to the eligibility criteria for the child tax benefit. These subsections are repealed, after August 27, 1995, as the Minister of National Revenue will be entirely responsible for the child tax benefit provisions.

Subclause 113(5)

ITA
165(5)

Subsection 165(5) of the Act provides that the Minister of National Revenue may reassess tax for a year after receiving a notice of objection from a taxpayer, even though the reassessment is made beyond the period provided for under paragraph 152(4)(b) or (c) for making a reassessment. This subsection is amended as a consequence of the amendments to subsection 152(4) and the addition of new subsection 152(4.01). It effectively provides that the limitations imposed by these subsections as to, respectively, the time within which the Minister may reassess and the scope of such reassessments are not applicable to a reassessment made pursuant to a notice of objection filed by a taxpayer. Subsection 152(5) will, however, continue to circumscribe the Minister's power to reassess beyond the normal reassessment period in such cases. Subsection 165(5) applies after April 27, 1989.

Clause 114

Appeals

ITA
169(2)

Subsection 169(2) of the Act restricts, in certain cases, the matters with respect to which a taxpayer may appeal to those matters which

gave rise to the assessment or determination that is under appeal. The amendments to subsection 169(2) are consequential to the introduction of subsection 152(1.8) of the Act, which allows the Minister to assess the tax liability of, or to determine any amount deemed to have been paid or to have been an overpayment by, a taxpayer who was believed to be a member of a partnership or any other affected persons. Such an assessment or determination may be made only to give effect to a determination made under subsection 152(1.4) in respect of the entity that was believed to be a partnership.

The right of a taxpayer who was believed to be a member of a partnership to appeal an assessment or determination made in respect of that partnership under new subsection 152(1.8) will be restricted to the matters that were relevant in the making of a determination at the partnership level or that result from the finding that the taxpayer is not a member of the partnership or that there is no such partnership.

These amendments apply to determinations made after Royal Assent.

Clause 115

Large Corporations Tax

ITA
181.1(7)

A corporation may deduct, in computing its Part I.3 tax liability for a taxation year, an amount equal to the total of its Canadian surtax payable for the year and such amount as it chooses of its unused surtax credits for the seven preceding and three following taxation years that end after 1991. In general terms, a corporation’s Canadian surtax payable is that portion of its corporate surtax that is attributable to its Canadian activities, and an unused surtax credit is the amount by which a corporation’s Canadian surtax payable exceeds its tax payable under Part I.3.

Subsection 181.1(7) of the Act restricts the amount deductible in respect of a corporation’s unused surtax credits where control of the corporation has been acquired between the year in which the credits arose and the year in which they are sought to be claimed. Currently,

subsection 181.1(7) provides that a corporation's unused surtax credits for a taxation year ending before control is acquired are deductible (pursuant to the carry-over provisions of Part I.3) in a taxation year ending after control is acquired only if the business to which the credits relate is carried on throughout the later year, and only against that proportion of the corporation's Part I.3 tax payable for the later year that its income from the continued business or similar businesses in the later year is of the corporation's total taxable income in such later year. Similar restrictions apply in deducting an unused surtax credit for a taxation year ending after the time at which control of a corporation has been acquired in computing a corporation's tax payable under Part I.3 for a taxation year ending before that time.

This amendment to subsection 181.7 changes the carry-over rules so that the portion of unused surtax credits that can be carried through a change of control will be based on the income from the continued business in the taxation year in which the surtax credits arise, and not the year against which the credits are sought to be applied. Specifically, paragraph 181.1(7)(a) of the Act is amended to provide that unused surtax credits for a particular taxation year ending before an acquisition of control may be deducted in a taxation year that ends after that time only to the extent of that proportion of its Canadian surtax payable for the earlier year that its income from the business or a similar business for the earlier year is of its total taxable income for that year. As before, the carryover of unused surtax credits is limited to the situation where the pre-change-of-control business is carried on throughout the subsequent year to which the unused surtax credits are being applied. Similar restrictions will apply where unused surtax credits are being carried back to pre-change-of-control years (see new paragraph 181.1(7)(b) of the Act).

These amendments apply to acquisitions of control that occur after April 26, 1995.

Clause 116

Large Corporations Tax - Calculation of Capital

ITA
181.2(3)

In general terms, a corporation is required to compute amounts relevant in determining its tax payable under Part I.3 of the Act using generally accepted accounting principles (GAAP).

The Canadian Institute of Chartered Accountants' Handbook (the "Handbook"), which is the principal source of GAAP in Canada, requires that the carrying values of foreign-denominated monetary assets and liabilities reflect unrealized foreign exchange gains and losses on such items. The Handbook also requires that certain of these unrealized foreign exchange gains and losses be deferred and amortized into income over the life of the monetary item.

New paragraph 181.2(3)(b.1) applies to specifically include in capital unrealized foreign exchange gains that have been deferred in accordance with GAAP. Conversely, new paragraph 181.2(3)(k) permits deferred unrealized foreign exchange losses to be deducted from a corporation's capital. An amendment to paragraph 181.2(3)(g) provides similar treatment of a corporation's share of any deferred unrealized foreign exchange gains and losses of a partnership of which it is a member.

These amendments apply to the 1995 and subsequent taxation years.

Clause 117

Large Corporations Tax - Taxable Capital of Financial Institutions

ITA
181.3(3)(d)(i)

Subsection 181.3(3) of the Act contains the rules for determining the capital of a financial institution for the purpose of Part I.3. Paragraph 181.3(3)(d) applies to a non-resident insurer.

Subparagraph 181.3(3)(d)(i) provides that the capital of a non-resident insurer includes the greater of its surplus funds derived from operations and its attributed surplus.

Subparagraph 181.3(3)(d)(i) is amended to take into account amounts on which the insurer has paid branch tax under Part XIV of the Act, and amounts on which it was not required to pay that tax because of an election under subsection 219(5.2). These amounts for preceding taxation years are subtracted from surplus funds derived from operations. A current year amount is also subtracted if it arises because of the transfer of an insurance business where subsection 138(11.5) or (11.92) of the Act has applied to the transfer.

This amendment applies to the 1994 and subsequent taxation years.

Clause 118

Large Corporations Tax - Taxable Capital of Non-Residents

ITA
181.4(d)(i)

Section 181.4 of the Act provides rules for determining the taxable capital employed in Canada of a non-resident corporation (other than a financial institution) for the purposes of Part I.3 of the Act. Paragraph 181.4(d) excludes from this amount the carrying value of an asset that is a ship or an aircraft operated by a non-resident corporation in international traffic, or that is personal property used in its business of transporting passengers or goods in international traffic, where the country in which the corporation is resident does not impose a capital tax on similar assets, or a tax on the income therefrom, of any corporation resident in Canada.
Subparagraph 181.4(d)(i) is amended to clarify that personal property, other than ships and aircraft, is excluded only where that property is used in the business of transporting passengers or goods by ship or aircraft in international traffic.

This amendment applies to the 1995 and subsequent taxation years.

Clause 119

Large Corporations Tax - Related Corporations

ITA
181.5(6)

Section 181.5 of the Act sets out rules for determining a corporation's capital deduction for a taxation year, for the purposes of Part I.3 of the Act. Generally, under section 181.5 the members of a group of related corporations that are associated with one another share a single $10,000,000 deduction. For the most part, the Act's ordinary tests will apply in determining whether corporations are related for this purpose. Subsection 181.5(6) provides an exception: two corporations that would be related only because of the control of a corporation by Her Majesty or a right referred to in paragraph 251(5)(b) of the Act will not be treated as being related. This exception in turn contains an exception: if a taxpayer has a right referred to in paragraph 251(5)(b) with respect to shares, and it can reasonably be considered that the taxpayer acquired the right to avoid a limitation on a corporation's capital deduction, the corporations will be treated as being in the same relationship to each other as if the taxpayer owned the shares.

As a consequence of the amendment of paragraph 251(5)(b), the exception to the subsection 181.5(6) rule is amended. Rather than being treated as though the taxpayer in question owned the shares, the corporations will be treated as if the right the taxpayer acquired to avoid the limitation were an immediate and absolute right, and as if the taxpayer had exercised it. This ensures that the provision deals not only with rights to acquire shares, but also with rights to affect shares' voting rights.

This amendment applies after April 26, 1995.

Clause 120

Large Corporations Tax - Application to Crown Corporations

ITA
181.71

New section 181.71 of the Act, which applies to taxation years that end after June 1989, confirms that a prescribed federal Crown corporation is liable to tax under Part I.3 of the Act. Specifically, the new section provides that section 27 of the Act applies to Part I.3 with whatever modifications may be necessary. The main effects of section 27 are to treat income and property of Her Majesty that is administered by a Crown corporation that is an agent of Her Majesty as though they were the corporation's own, and to provide that the exemption in paragraph 149(1)(d) does not apply.

Clause 121

Part IV tax - exempt corporations

ITA
186.1(b)

Section 186.1 of the Act exempts certain corporations from the requirement to pay the special refundable Part IV tax on dividend income. Paragraph 186.1(b) lists a number of types of corporations to which the exemption applies, including corporations described in paragraphs 39(5)(b) and (c) (banks and trust companies).
Section 186.1 is amended, as a consequence of amendments to subsection 39(5), to replace the reference to paragraphs 39(5)(b) and (c) by the descriptions that were contained in those paragraphs. This amendment applies after February 22, 1994.

Clause 122

Part IV.1 - Application to Crown Corporations

ITA
187.61

New section 187.61 of the Act, which applies after 1987, confirms that a prescribed federal Crown corporation is liable to tax under Part IV.1 of the Act. Specifically, the new section provides that section 27 of the Act applies to Part IV.1 with whatever modifications may be necessary. The main effects of section 27 are to treat income and property of Her Majesty that is administered by a Crown corporation that is an agent of Her Majesty as though they were the corporation's own, and to provide that the exemption in paragraph 149(1)(d) does not apply.

Clause 123

Tax on Capital of Financial Institutions - Calculation

ITA
190.1(6)

Part VI of the Act levies a tax on the taxable capital employed in Canada of large financial institutions. Section 190.1 of the Act establishes the rate of that tax.

A financial institution is permitted to reduce its Part VI tax payable by an amount equal to the total of its Part I tax liability for the year and such amount as it chooses of its unused Part I tax credits and unused surtax credits for the seven preceding and three following taxation years that end after 1991 (or after 1990, where a special election is made). In general terms, a corporation's unused Part I tax credit is the amount by which its Part I tax payable for a year exceeds the sum of its Part VI tax payable and Canadian surtax payable for the year, and its unused surtax credit is the amount by which its Canadian surtax payable exceeds its tax payable under Part I.3 of the Act for the year.

Subsection 190.1(6) of the Act restricts the amount deductible under Part VI in respect of a corporation's unused surtax and Part I tax credits where control of the corporation has been acquired between the year in which the credits arose and the year in which they are sought to be claimed. Currently, subsection 190.1(6) provides that a corporation's unused surtax and Part I tax credits for a taxation year ending before control is acquired are deductible (pursuant to the carryover provisions of Part VI) in a taxation year ending after control is acquired only if the business to which the tax relates is carried on throughout the later year and only against that proportion of the corporation's Part VI tax payable for the later year that its income from the continued business or similar businesses in the later year is of the corporation's total taxable income in such later year. Similar restrictions apply in deducting a credit in respect of Part I tax for a taxation year ending after the time at which control of a corporation has been acquired in computing a corporation's tax payable under Part VI for a taxation year ending before that time.

This amendment to subsection 190.1(6) changes the carry-over rules so that the portion of unused surtax and Part I tax credits that can be carried through a change of control will be based on the income from the continued business in the taxation year in which the Part I tax credits arise, and not the year against which the credits are sought to be applied. Specifically, paragraph 190.1(6)(a) of the Act is amended to provide that unused surtax and Part I tax credits for a particular taxation year that ends before an acquisition of control may be deducted in a taxation year that ends after that time only to the extent of that proportion of its Part I tax payable for the earlier year that its income from the business or a similar business for the earlier year is of its total taxable income for that year. As before, the carryover of unused surtax and Part I tax credits is restricted to the situation where the pre-change-of-control business is carried on throughout the subsequent year to which the unused surtax and Part I tax credits are being applied. Similar restrictions will apply where unused surtax and Part I tax credits are being carried back to pre-change-of-control years (see new paragraph 190.1(6)(b) of the Act).

These amendments apply to acquisitions of control that occur after April 26, 1996.

Clause 124

Determination of Capital of Financial Institutions

ITA
190.13(c)(i)

Section 190.13 of the Act contains the rules for determining the capital of a financial institution for the purpose of Part VI of the Act. Paragraph 190.13(c) applies to a non-resident insurer. Subparagraph 190.13(c)(i) provides that the capital of a non-resident insurer includes the greater of its surplus funds derived from operations and its attributed surplus.

Subparagraph 190.13(c)(i) is amended to take into account amounts on which the insurer has paid branch tax under Part XIV of the Act, and amounts on which it was not required to pay that tax because of an election under subsection 219(5.2). These amounts for preceding taxation years are subtracted from surplus funds derived from operations. A current year amount is also subtracted if it arises because of the transfer of an insurance business where subsection 138(11.5) or (11.92) of the Act has applied to the transfer.

This amendment applies to the 1994 and subsequent taxation years.

Clause 125

Tax on Capital of Financial Institutions - Related Corporations

ITA
190.15(6)

Section 190.15 of the Act sets out rules for determining the capital deduction, for the purposes of Part VI of the Act, of a corporation that is a financial institution. Generally, under section 190.15 the members of a group of related financial institutions share a single $10,000,000 deduction. For the most part, the Act’s ordinary tests will apply in determining whether corporations are related for this purpose. Subsection 190.15(6) provides an exception: two corporations that would be related only because of the control of a corporation by Her Majesty or a right referred to in

paragraph 251(5)(b) of the Act will not be treated as being related. This exception in turn contains an exception: if a taxpayer has a right referred to in paragraph 251(5)(b) with respect to shares, and it can reasonably be considered that the taxpayer acquired the right to avoid a limitation on a corporation's capital deduction, the corporations will be treated as being in the same relationship to each other as if the taxpayer owned the shares.

As a consequence of the amendment of paragraph 251(5)(b), the exception to the subsection 190.15(6) rule is amended. Rather than being treated as though the taxpayer in question owned the shares, the corporations will be treated as if the right the taxpayer acquired to avoid the limitation were an immediate and absolute right, and as if the taxpayer had exercised it. This ensures that the provision deals not only with rights to acquire shares, but also with rights to affect shares' voting rights.

This amendment applies after April 26, 1995.

Clause 126

Tax on Capital of Financial Institutions - Application to Crown Corporations

ITA
190.211

New section 190.211 of the Act, which applies after May 23, 1985, confirms that a prescribed federal Crown corporation is liable to tax under Part VI of the Act. Specifically, the new section provides that section 27 of the Act applies to Part VI with whatever modifications may be necessary. The main effects of section 27 are to treat income and property of Her Majesty that is administered by a Crown corporation that is an agent of Her Majesty as though they were the corporation's own, and to provide that the exemption in paragraph 149(1)(d) does not apply.

Clause 127

Computation of Taxable Capital Employed in Canada

ITA
Part VI

Subsection 190.1(1.1) of the Act imposes an additional temporary Part VI tax on the taxable capital employed in Canada of life insurance corporations. This tax was set at a rate which, when combined with basic Part VI tax, would generate an appropriate amount of tax from the industry. Whether deferred realized gains and losses on investment properties are required to be included in or excluded from the Part VI tax base is determined in accordance with the provisions of Part VI. Deferred realized gains on investment properties would, if included in the base for the period during which the additional tax is in effect, impose a level of tax on the life insurance industry that was higher than intended. Thus, this amendment excludes such gains and losses from taxable capital employed in Canada for the period between February 25, 1992 and 1996 – that is, while the additional Part VI tax on life insurance corporations applies.

Clause 128

Agreement Respecting Liability for Tax

ITA
191.3

Section 191.3 of the Act allows a corporation to transfer its Part VI.I tax liability to a related corporation provided a joint agreement for the transfer is filed with the Minister of National Revenue. Such transfers are beneficial where the transferor corporation does not have sufficient Part I tax to utilize the deduction for Part VI.I tax that is provided under paragraph 110(1)(k) of the Act.

Among other conditions in subsection 191.3(1), the transferor corporation must be related to the transferee corporation throughout both the transferor's taxation year for which the tax sought to be transferred would be payable, and the last taxation year of the

transferee corporation ending at or before the end of that taxation year of the transferor. Where the transferee was incorporated in that taxation year of the transferor, the transferee will be unable to satisfy the requirement that it be related to the transferor throughout that year. A similar problem arises where the transferor is incorporated during the last taxation year of the transferee corporation. Paragraphs 191.3(1)(a) and (b) are amended to allow tax transfers in such circumstances provided that the transferor and transferee are related throughout the balance of each company's taxation year in which the transferor or transferee, as the case may be, were incorporated. This amendment applies to taxation years of the transferor corporation that begin after 1994. A special transitional rule extends the time limit for corporations to file an agreement to transfer a Part VI.I tax liability under subsection 191.3(2) where that agreement arises because of the amendment to paragraph 191.3(1)(a) or (b).

Section 191.3 is also amended so that corporations related only by reason of being controlled by Her Majesty will not be permitted to transfer their Part VI.I tax liability to one another. This amendment applies only to taxation years of the transferor corporation that end after April 26, 1995.

Clause 129

Part VI.1 - Application to Crown Corporations

ITA
191.4(3)

New subsection 191.4(3) of the Act, which applies after 1987, confirms that a prescribed federal Crown corporation is liable to tax under Part VI.1 of the Act. Specifically, the new section provides that section 27 of the Act applies to Part VI.1 with whatever modifications may be necessary. The main effects of section 27 are to treat income and property of Her Majesty that is administered by a Crown corporation that is an agent of Her Majesty as though they were the corporation's own, and to provide that the exemption in paragraph 149(1)(d) does not apply.

Clause 130

Labour-Sponsored Venture Capital Corporations

ITA
204.8

"specified active business"

Section 204.81 of the Act sets out the conditions for the registration of labour-sponsored venture capital corporations (LSVCCs). Under section 127.4, individuals acquiring Class A shares issued by LSVCCs are entitled to a tax credit. Registered LSVCCs must ultimately invest sufficient amounts in qualifying securities issued by eligible business entities (as defined by section 204.8), in order to avoid penalty taxes levied under section 204.82. One of the requirements for a corporation or partnership to qualify as an "eligible business entity" is that it, or a related entity, carries on a "specified active business".

"Specified active business" is defined in section 204.8 as an active business (as defined by subsection 248(1)) carried on in Canada, where at least 50% of the full-time employees of the business are employed in Canada and at least 50% of the wages and salaries paid to employees of the business are attributable to services rendered in Canada by employees.

The definition of "specified active business" in section 204.8 is amended to clarify that qualification at any time as a "specified active business" is determined with reference to those individuals employed at that time in respect of the business. This amendment is made only to be consistent with the wording of the proposed definition of "specified active business" in subsection 206(1).

This amendment applies after 1988.

Clause 131

Labour-Sponsored Venture Capital Corporations

ITA
204.82(2)

Subsection 204.82(2) of the Act imposes a tax on a registered labour-sponsored venture capital corporation (RLSVCC) where, at any time after the fifth taxation year of the RLSVCC ending after it first issues a Class A share, it fails to achieve a required level of eligible investments in eligible business entities. This level at any time in a taxation year is determined as 60% of the lesser of the amount of the shareholders' equity of the RLSVCC determined at the end of the preceding taxation year and the amount of the shareholders' equity of the RLSVCC determined at the end of the year (in both cases determined without taking into account any unrealized gains or losses on eligible investments of the RLSVCC). Where at any time in a month the total cost of the RLSVCC's eligible investments falls short of the required investment level, the RLSVCC is required to pay a tax in respect of the shortfall equal to the greatest such shortfall in the month multiplied by 1/60 of the prescribed rate of interest in effect for the month. This tax is payable in respect of each month in which such a shortfall occurs.

Subsection 204.82(3) provides for an additional tax where an RLSVCC is required to pay the tax described in subsection 204.82(2) in respect of 12 consecutive months. This additional tax is calculated as 20% of the average investment shortfall for those 12 months, minus the total of all taxes paid or payable under this subsection or subsection 204.82(1) by the RLSVCC in respect of preceding taxation years (net of all amounts previously refunded by reason of section 204.83 to the RLSVCC in respect of the tax payable under this subsection).

Where an RLSVCC is liable to pay a tax under subsection 204.82(3), subsection 204.82(4) imposes a penalty on the RLSVCC, in addition to the tax, of an amount equal to the tax.

Section 204.83 requires the Minister of National Revenue to refund to an RLSVCC 100% of the tax payable under subsection 204.82(3) and 80% of the penalty payable under subsection 204.82(4) where,

throughout any 12-month period commencing after the 12-month period in respect of which the tax became payable, the RLSVCC has maintained the required level of eligible investments.

Subsection 204.82(2) is amended so that the required investment level at any time in a taxation year is no more than 60% of the amount of the shareholders' equity of the RLSVCC as of the end of the second preceding taxation year, determined without taking into account any unrealized gains or losses on eligible investments of the RLSVCC.

This amendment applies to taxation years ending after 1994 and before March 1, 1997.

Clause 132

Foreign Property Tax

ITA
206

Section 206 of the Act imposes a tax on the amount of "foreign property" (as defined in subsection 206(1)) held by pension funds and others in excess of defined limits.

Subclauses 132(1) to (4)

ITA
206(1)

"foreign property"

"Foreign property" is defined in subsection 206(1) of the Act. Under paragraph (d.1) of the definition, foreign property includes certain shares and debts issued by Canadian corporations, if shares of the corporation may reasonably be considered to derive their value primarily from "portfolio investments" in foreign property. Under paragraph (e) of the definition, foreign property includes, except as prescribed by regulation, shares of the capital stock of mutual fund corporations (other than investment corporations or registered investments).

Paragraph (d.1) of the definition is amended to provide that any share or debt issued by a corporation that is a Canadian corporation is, subject to the exceptions described below, considered to be foreign property where shares of the corporation can reasonably be considered to derive their value primarily from foreign property (whether or not the foreign property is a "portfolio investment"). The purpose of this amendment and the exceptions described below are to remove the uncertainty regarding the application of the foreign property rules in cases where a Canadian corporation acquires minority or controlling interests in corporations deriving their value from foreign property. This amendment applies to property acquired after 1995.

Paragraph (d.1) of the definition is also amended so that shares and debts issued by a corporation that is a Canadian corporation are not considered as foreign property under that paragraph where the Canadian corporation has a substantial presence in Canada. The determination of substantial Canadian presence is set out in new subsection 206(1.1).

Paragraph (d.1) of the definition is also amended so that it does not apply to shares or debts issued by mutual fund corporations, investment corporations or registered investments. Mutual fund corporations and investment corporations that are not registered investments are subject to a stricter foreign property regime as a consequence of amended paragraph (e) of the definition and Part L of the *Income Tax Regulations*. A "registered investment" is a trust or a corporation that is subject to tax under Part XI of the Act with respect to its own investments, so it is not appropriate for shares or debts issued by registered investments to be considered as foreign property.

Paragraph (d.1) of the definition is also amended so that certain shares, described in the new definition of "excluded share" in subsection 206(1), are not considered to be foreign property under paragraph (d.1). An "excluded share" is defined as:

- a share that is of a class of shares listed on a prescribed stock exchange in Canada, where no share of that class has been issued after December 4, 1985 (otherwise than pursuant to an agreement in writing entered into before 5:00 p.m. Eastern Standard Time on December 4, 1985),

- a share last acquired after 1995 that is of a class of shares listed on a prescribed stock exchange in Canada, where

  - the share would, if paragraph (d.1) of the definition of "foreign property" applied only in respect of portfolio investments, not be foreign property, and

  - no share of that class has been issued after July 20, 1995 (otherwise than pursuant to an agreement in writing made before July 21, 1995), and

- a share last acquired after 1995 as a consequence of the exercise of a right acquired before 1996 where the share would, if paragraph (d.1) of the definition of "foreign property" applied only in respect of portfolio investments, not be foreign property.

The first part of the "excluded share" definition corresponds to grandfathering formerly provided in paragraph (d.1) of the definition. The second part extends similar grandfathering for shares acquired after 1995 that are affected by the expansion of "foreign property" under amended paragraph (d.1) of the definition. The third part extends grandfathering with respect to shares acquired after 1995 pursuant to the exercise of a right acquired before 1996.

Except as noted above, the amendments to paragraph (d.1) of the definition apply to shares and debts that were acquired after December 4, 1985 (otherwise than pursuant to an agreement in writing made before 5:00 p.m. Eastern Standard Time on December 4, 1985). This coming-into-force provision corresponds to the coming-into-force with respect to the introduction of paragraph (d.1) of the definition.

Paragraph (e) of the definition is amended to provide that, except as prescribed by regulation, a share issued by an investment corporation (as defined by subsection 130(3)) is considered to be "foreign property", unless it was acquired before October 14, 1971. For this purpose, existing subsections 5000(3) and (4) of the Regulations set out the circumstances where such a share is not considered to be foreign property. This amendment, which is consequential to the repeal of subsection 206(3), applies to months that end after June 1995.

Paragraph (g) of the definition "foreign property" is amended by adding the European Bank for Reconstruction and Development to the list of non-resident organizations the indebtedness of which is exempt from the definition of "foreign property". This amendment applies to months after March 1991.

ITA
206(1)
"affiliate"
"carrying value"
"designated value"
"excluded share"
"investment activity"
"qualified property"
"significant interest"
"specified active business"
"specified proportion"

Subsection 206(1) of the Act is amended to introduce definitions of "affiliate", "carrying value", "designated value", "investment activity", "qualified property", "specified active business" and "specified proportion". These definitions are used in new subsections 206(1.1) and (1.2), which are discussed in the commentary below.

Subsection 206(1) is also amended to introduce the definition of "excluded share", which is used only in amended paragraph (d.1) of the definition "foreign property" in subsection 206(1). It is discussed in the commentary above.

Subsection 206(1) is also amended to introduce the definition of "significant interest", which is used only in the new definition "investment activity". It is discussed in the commentary below on paragraph 206(1.1)(d).

ITA
206(1.1)(a) to (c) and (1.2)

Paragraphs 206(1.1)(a) to (c) of the Act provide relief from the application of paragraph (d.1) of the definition "foreign property" with respect to shares and debts issued by corporations that are Canadian corporations and have a substantial Canadian presence, in accordance with the tests below. Each of the paragraphs provides a

test for substantial Canadian presence. Paragraphs 206(1.1)(d) and (e), discussed in the commentaries below, provide additional tests for substantial Canadian presence.

In this context, a share or debt obligation issued by a corporation will not be considered to be foreign property of a taxpayer under paragraph 206(1.1)(a) where, at any time in any of the last 15 months beginning before the acquisition of the share or debt or at any time in the calendar year that includes the acquisition time, the "designated value" of "qualified property" of the corporation and "affiliates" of the corporation exceeded $50 million. Definitions of these expressions are provided in amended subsection 206(1).

The $50 million test is designed to be a one time test. If a share or debt satisfies the $50 million test, a change in the circumstances of the issuing corporation will not result in the share or debt being reclassified as foreign property of the purchaser while continuously held by the purchaser.

Even if the $50 million test is not met, paragraph 206(1.1)(b) allows a share or debt issued by a corporation to be temporarily considered as not being foreign property for up to 15 months after the acquisition. This relief applies in respect of shares or debts issued by a corporation, where the total "designated value" of "qualified property" of the corporation (and other corporations controlled by the corporation) exceeds 50% of the lesser of the fair market value of all the corporation’s property and its "carrying value" (as defined in subsection 206(1)). This test must be satisfied at any time in any of the last 15 months beginning before the time of the acquisition. As described below, a share or debt that is excluded from foreign property classification under paragraph 206(1.1)(b) can continue to be so excluded under paragraph 206(1.1)(c).

Paragraph 206(1.1)(c) also allows for a share or debt issued by a corporation to be excluded from foreign property classification for a taxpayer. In order for a share or debt to be so excluded at a particular time, it must satisfy the 50% test described above at any time in any of the first 15 months beginning after the time of acquisition. (In the event that a share or debt initially excluded from foreign property because of paragraph 206(1.1)(b) becomes foreign property because it fails to satisfy paragraph 206(1.1)(c), relief is provided under existing subparagraph 206(2)(a)(iii). This relief has the effect of ignoring such

foreign property for 24 months for the purposes of computing the Part XI tax.)

Subsection 206(1.2) provides a specific rule, relevant for the purposes of applying the tests in paragraphs 206(1.1)(a) to (c) above, to take into account partnerships. For the purposes of these paragraphs, a member of a partnership is deemed not to own any interest in the partnership at any time. Instead, the member is deemed to own the member's "specified proportion" (for the first fiscal period ending at or after that time) of each partnership property owned at that time. The "specified proportion" of a member of a partnership for a fiscal period of the partnership, as defined in subsection 206(1), is the proportion that the member's share of the total income or loss of the partnership for the partnership's fiscal period is of the partnership's total income or loss for that period. However, where such income or loss for a period is nil, the "specified proportion" is computed as if the partnership had income for that period in the amount of $1 million. The "carrying value" of the member's specified proportion of partnership property is likewise deemed to be the member's specified proportion of the carrying value of the partnership's property.

These amendments apply after December 4, 1985.

ITA
206(1.1)(d) and (1.3)

New paragraph 206(1.1)(d) of the Act provides the fourth of the five tests for substantial Canadian presence for a Canadian corporation. Unlike the other tests under paragraphs 206(1.1)(a) to (c), this test is designed to apply on an ongoing basis. However, should a corporation cease to qualify under the criteria established in this paragraph, relief is provided under existing subparagraph 206(2)(a)(iii) for up to 24 months. Under paragraph 206(1.1)(d), a share or a debt obligation issued by a corporation will not be considered to be a foreign property of a taxpayer at a particular time where the particular time is after 1995 and three further conditions are met.

The first condition is satisfied where the issuing corporation is required to maintain an office in Canada under the laws by or under which it was incorporated or continued. Alternatively, where the corporation was not required to maintain an office under the laws by

or under which it was incorporated or continued, this condition is satisfied where the maintenance of an office in Canada is required under the constitutional documents of the corporation.

The second condition is satisfied where, in accordance with the governing corporate law or its constitutional documents, the corporation actually does maintain an office in Canada.

The third condition is satisfied where any of the following criteria is met:

- the corporation employs more than 5 individuals in Canada full time (other than individuals employed in connection with an "investment activity" of the corporation or a business carried on by the corporation through a partnership of which the corporation is not a majority interest partner),

- another corporation that is controlled by the corporation employs more than 5 individuals in Canada full time (other than individuals employed in connection with an "investment activity" of the corporation, or a business carried on by the corporation through a partnership of which the corporation is not a majority interest partner),

- the total amount incurred by the corporation for the services (other than services relating to an "investment activity") of employees and other individuals rendered in Canada in any calendar year that ends in the any of the last 15 months that end before the particular time exceeds $250,000, or

- the total amount incurred by another corporation that is controlled by the corporation for the services (other than services relating to an "investment activity") of employees and other individuals rendered in Canada in any calendar year that ends in the any of the last 15 months that end before the particular time exceeds $250,000.

For the purposes of the third condition, it is relevant whether or not the issuing corporation or a corporation controlled by it (referred to below as the "relevant corporation") is considered to carry on an "investment activity". As defined in subsection 206(1), an investment activity of a corporation generally includes any business carried on by

the corporation where the principal purpose of the business is to derive income from, or to derive profits from the disposition of, a number of listed properties (shares, trust interests, indebtedness, etc.) set out in the definition. If the corporation is not considered to carry on a business for tax purposes, the holding of such properties for such purposes likewise would generally be considered to be an "investment activity".

However, there is an important exception from this definition to the extent that the properties so held are shares and debts issued by other corporations in which the relevant corporation has a "significant interest". Where this is the case, such shares and debts are ignored, provided that the primary activity of the other corporation is not an "investment activity". Under the definition "investment activity", a relevant corporation has a significant interest in another corporation where

- the relevant corporation is related (otherwise than because of a right referred to in paragraph 251(5)(b)) to the other corporation, or

- the relevant corporation holds shares of the capital stock of the other corporation and those shares represent at least 10% of the fair market value of, and the votes at an annual general meeting associated with, all issued shares of the other corporation.

Subsection 206(1.3) also provides a relieving rule relevant in applying the third condition, above. For this purpose, an employee of a corporation is deemed to be employed in Canada where the corporation's permanent establishment to which the employee principally reports is situated in Canada. In addition, services are deemed to be rendered in Canada to a corporation where the permanent establishment for which the services are rendered is situated in Canada. Note, in this regard, that it is contemplated that services could be rendered to a corporation directly (i.e., where the relevant corporation employs the individual or contracts directly with the individual) or indirectly (e.g., where the relevant corporation engages another corporation the employees of which render services to the relevant corporation).

These amendments apply after 1995.

ITA
206(1.1)(e)

New paragraph 206(1.1)(e) of the Act provides the last of the five tests for substantial Canadian presence for a Canadian corporation. As under paragraph 206(1.1)(d), this test is designed to apply on an ongoing basis. Should a corporation cease to qualify for relief under this paragraph, relief is provided under existing subparagraph 206(2)(a)(iii) for up to 24 months. Under paragraph 206(1.1)(e), a share or a debt obligation issued by a corporation will not be considered to be a foreign property of a taxpayer at a particular time where the particular time is after 1995 and all or substantially all of the property of the corporation is not foreign property.

This amendment applies after 1995.

ITA
206(1.4)

Paragraphs (f) and (h) of the definition "foreign property" in subsection 206(1) of the Act apply in the event that a taxpayer has a right to, or a non-ownership interest in, another property. Paragraph (f) also generally applies where a taxpayer has property that is convertible into, or exchangeable for, another property. In these circumstances, the property owned by a taxpayer is generally treated as foreign property if the other property is foreign property.

New subsection 206(1.4) provides that, in these circumstances, the determination of whether property owned by a taxpayer is foreign property at any time is based on whether the other property would be foreign property if it had been acquired immediately before that time. This provision is necessary because the tests in new paragraphs 206(1.1)(a) to (c) are predicated on there being an acquisition of a share or debt obligation.

This amendment applies after December 4, 1985.

ITA
206(1.5)

Subsection 206(1.5) of the Act is a rule which is provided for administrative convenience and ensures that properties owned by a single taxpayer are treated consistently for the purposes of the foreign property rules.

Subsection 206(1.5) provides that, where a share or debt obligation issued by a Canadian corporation (or an interest in or right to a share issued by a Canadian corporation) is excluded from classification as a foreign property of a taxpayer, any identical property held by the taxpayer is likewise excluded. This provision would be relevant, for example, if a taxpayer acquired shares of a corporation at the time the $50 million test was satisfied and subsequently the same taxpayer acquired shares when the $50 million test was not satisfied. In addition, this provision may also be relevant in the event that identical properties are acquired before 1996 and after 1995 and the property acquired before 1996 is not foreign property because of the timing of its acquisition.

Subsection 206(1.5) also provides that, where a taxpayer has an interest in or right to a share or debt issued by a Canadian corporation (or property that is exchangeable for or convertible into a share or debt issued by a Canadian corporation), the interest, right or property is not considered to be foreign property because of paragraph (f) or (h) of the definition "foreign property" in subsection 206(1) if the taxpayer actually owns another property identical to the share or debt that is not considered to be foreign property. This would be relevant, for example, where a taxpayer has an option to acquire a share issued by a Canadian corporation and also has an identical share that is not classified as foreign property because of subsection 206(1.1). Where this is the case, there would be no need to test the classification of the option as a foreign property on an on-going basis under new subsection 206(1.4).

These amendments apply after December 4, 1985.

Subclause 132(5)

ITA
206(2.01)

Subsection 206(2) of the Act imposes a 1% per month tax on deferred income plans and certain other taxpayers, including "registered investments" (corporations and trusts registered under Part X.2 of the Act). The 1% per month is generally applied to the cost of such a taxpayer's foreign property holdings that is in excess of 20% of the cost of their total property. A registered investment is subject to Part XI tax because shares and interests issued by a registered investment are expressly excluded from other taxpayers' foreign property for the purposes of Part XI, no matter what the level of the registered investment's foreign content.

New subsection 206(2.01) provides limited relief for registered investments from the Part XI tax otherwise determined under subsection 206(2). It is expected that registered investments will make use of the new rule only where they have significantly over-invested in foreign property, without regard to their status as registered investments. The rule is not designed to encourage registered investments to invest more in foreign property.

Relief for a registered investment from Part XI tax is provided only where there are interests in the registered investment (or shares of the capital stock of the registered investment where the registered investment is a corporation) that are held by taxpayers other than:

- deferred income plans, registered investments and other taxpayers described in paragraphs 205(a) to (f),

- mutual fund corporations, investment corporations and mutual fund trusts, and

- trusts and partnerships to be prescribed, as set out below.

As a consequence of subsection 206(2.01), the maximum tax payable under Part XI by a registered investment in respect of a month is limited to the greater of:

- $5,000 plus a specified percentage of the tax otherwise determined in subsection 206(2) in respect of the month. (The specified percentage is the percentage that the total fair market value of all interests/shares in the registered investment that are held by the taxpayers listed above is of the total fair market value of all the interests/shares in the registered investment.); and

- 20% of the tax otherwise determined under subsection 206(2) in respect of the month.

It is intended to amend Part L of the *Income Tax Regulations* to prescribe certain trusts and partnerships so that they are included in the list of taxpayers above. A trust will be prescribed for this purpose where it is a pooled fund trust (as defined by subsection 5000(7) of the Regulations), it would be a mutual fund trust if the 150 beneficiary requirement set out in paragraph 4801(b) of the Regulations were ignored or it is a resource property trust (as defined by subsection 5000(7) of the Regulations) or a master trust described in paragraph 149(1)(o.4) of the Act. A partnership will be prescribed where it is a qualified limited partnership (as defined by subsection 5000(7) of the Regulations).

These amendments apply to months that end after 1992.

Subclause 132(6)

ITA
206(3)

Subsection 206(3) of the Act provides that, except as prescribed, a share of the capital stock of an investment corporation (other than a registered investment) acquired after October 13, 1971 by a taxpayer is deemed to be a foreign property of the taxpayer.

Subsection 206(3) is being repealed, strictly as a consequence of amended paragraph (e) in the definition "foreign property".

This amendment applies to months that end after June 1995.

Clause 133

Deferred Income Plans - Share Acquisition Agreements

ITA
206.1

Section 206.1 of the Act imposes a penalty tax on a pension fund or other deferred income plan that enters into an agreement to purchase shares at a price that may differ from their fair market value at the time that the purchase is to take place. The penalty is equal to 1% of the fair market value of the shares for each month that the agreement is outstanding. The provision is intended to discourage tax-exempt entities from temporarily transferring shares to persons who may be able to receive dividends on those shares on a tax-favoured basis. The provision is also intended to apply where the same result could be achieved by a delay in the acquisition of a share by the tax-exempt entity. However, the policy underlying this provision is respected when no dividends are paid while the agreement to purchase is outstanding or when the dividends paid are actually received by the tax-exempt entity.

Section 206.1 is amended to replace the 1% penalty tax with a tax equal to the amount of dividends paid during each month that the tax-exempt entity is a party to the agreement minus the amount of the dividends that are received by the tax-exempt entity.

Amended section 206.1 applies to agreements entered into after 1992. A transitional rule for agreements entered into after 1992 and before April 26, 1995 limits the tax to the lesser of 1% of the fair market value of the shares for each month that the agreement is outstanding and the amount of dividends paid on the shares during that time.

Clause 134

Tax on Investment Income of Life Insurers

ITA
211.1(3) and (4)

Part XII.3 of the Act levies a tax on the estimated investment income of life insurance companies. Subsection 211.1(3) provides a formula to determine an insurer's Canadian life investment income or loss for this purpose. Amounts A and D in this formula are determined by multiplying an annual interest rate by the maximum reserves that may be claimed by the insurer in respect of certain policies. Thus, these amounts include a full 12 months of imputed interest, regardless of the length of the insurer's taxation year.

The amendments provide for the proration of the imputed interest amounts where an insurer has a short taxation year. Specifically, amounts A and D in subsection 211.1(3) are amended to make them subject to new subsection 211.1(4). Subsection 211.1(4) provides that where an insurer's taxation year is less than 51 weeks in length, the amounts otherwise determined for A and D are multiplied by the ratio of the number of days in the year (not including February 29th) to 365.

These amendments apply to the 1992 and subsequent taxation years.

Clause 135

Tax on Investment Income of Life Insurers - Instalments

ITA
211.3

Section 211.3 of the Act requires a life insurer to pay quarterly instalments of Part XII.3 tax. These instalments are based on the lesser of the insurer's Part XII.3 tax for the current taxation year and its Part XII.3 tax for the preceding year. The instalment rules are being amended to take into account the length of the insurer's taxation years, and to require monthly instalments. These amendments, which apply to taxation years that begin after 1995, will

bring the instalment rules into closer conformity with the instalment rules for taxes payable under other Parts of the Act.

Existing section 211.3 is replaced by new subsections 211.3(1) and (2). Subsection 211.3(1) requires a life insurer to pay monthly instalments of Part XII.3 tax equal to 1/12 of the lesser of (i) the estimated amount of annualized Part XII.3 tax payable by the insurer for the year, and (ii) the annualized tax payable by the insurer for the preceding year.

It should be noted that, in determining the instalments for the first taxation year of a life insurer formed by the amalgamation of two or more corporations, the Part XII.3 tax payable by those predecessor corporations for their last taxation years will be used in paragraph 211.3(1)(b). This follows from the continuity rule in subsection 87(2.2) of the Act. Similarly, the continuity rule in paragraph 88(1)(g) of the Act will apply where a subsidiary that is an insurer is wound-up into its parent, and the continuity rule in paragraph 138(11.5)(k) of the Act will apply where an insurer transfers its business on a rollover basis to a Canadian corporation.

New subsections 211.3(1) and 211.5(2) of the Act refer to the annualized Part XII.3 tax payable by an insurer for a taxation year. New subsection 211.3(2) specifies how the annualized tax is to be calculated. If the insurer’s taxation year is at least 51 weeks in length, its annualized tax is equal to its Part XII.3 tax for the year. Otherwise, the insurer’s annualized tax is computed by multiplying its Part XII.3 tax for the year by the ratio of 365 to the number of days in the year (other than February 29th).

Clause 136

Tax on Investment Income of Life Insurers - Interest and Penalties

ITA
211.5

Section 211.5 of the Act provides that certain provisions of Part I of the Act relating to assessments, interest, penalties, objections and

appeals are also applicable to Part XII.3 of the Act. This section is renumbered as subsection 211.5(1).

New subsection 211.5(2) contains a rule relating to the application of subsection 161(2) and section 163.1 of the Act to instalments payable under Part XII.3. Subsection 161(2) provides for interest in respect of the late or deficient payment of instalments, while subsection 163.1 imposes a penalty in respect of late or deficient payments in some circumstances. New subsection 211.5(2) provides that, for the purpose of determining any interest or penalty, a life insurer is deemed to have been liable to pay monthly instalments based on the lesser of its annualized tax for the year and its annualized tax for the previous year. This differs from the instalment requirement in subsection 211.3(1), in that the actual tax for the current year is used in place of the taxpayer's estimate of the tax.

The amendments to section 211.5 apply to taxation years that begin after 1995.

Clause 137

Tax on Income of Non-Residents

ITA
212(9)

Subsection 212(9) of the Act provides an exemption from withholding tax under Part XIII of the Act with respect to certain amounts of a trust's income that are paid or credited to a non-resident beneficiary under the trust and that would otherwise be subject to withholding tax under paragraph 212(1)(c). The exemption applies only to the extent that the trust's income derives from dividends or interest received by the trust from a non-resident-owned investment corporation or from certain artistic royalties. If no Part XIII tax would have been payable with respect to the dividends, interest or royalties if they had been paid directly to the beneficiary, no Part XIII tax is payable with respect to distributions from trust income to non-resident beneficiaries deriving from such dividends, interest or royalties.

Subsection 212(9) is amended so that the exemption also applies with respect to all interest allocated to a non-resident beneficiary that is received by a mutual fund trust maintained primarily for the benefit of non-resident beneficiaries, provided no Part XIII tax would have been payable with respect to the interest if it had been paid directly to the non-resident beneficiary.

This amendment applies to amounts paid or credited after April 1995 to non-resident persons.

Clause 138

Election re Rents and Timber Royalties

ITA
216(4)

Section 216 of the Act allows a non-resident person to elect to be taxed under Part I of the Act on that person's net income from Canadian real property and timber royalties in lieu of paying Part XIII tax on the gross amount of such payments. Subsection 216(4) permits an agent of a non-resident person to withhold on the basis of the net amount of such rents or royalties where the non-resident person has filed an undertaking with the Minister of National Revenue to file a return of income for the year under Part I. Where the non-resident person fails to fulfil the undertaking or pay the proper amount of tax within the time provided for payment, the non-resident's agent becomes liable for the Part XIII tax which should have been withheld.

The amendment to this subsection corrects an error made in the Fifth Supplement of the Revised Statutes of Canada, 1985 which referred to the non-resident recipient of the payments, rather than the person receiving such payments on the non-resident's behalf, as the one having the obligations described in paragraphs 216(4)(a) and (b). This amendment also clarifies that an agent's liability will arise where a non-resident member of a partnership fails to fulfil the member's obligations under subparagraph 216(4)(b)(i) or (ii).

Amended subsection 216(4) applies to amounts paid or credited after November 1991.

Clause 139

Branch Tax

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. Together with the amendment of section 219.1 (see the following commentary on section 219.1), this amendment to section 219 simplifies Part XIV and better conforms it to the general scheme of the Act. This amendment applies to taxation years that begin after 1995.

A non-resident corporation may carry on business in Canada either through a subsidiary corporation or by operating a branch here. Dividends paid by a subsidiary to its non-resident parent company are subject to non-resident withholding tax under Part XIII of the Act, as modified by any applicable tax treaty. In the case of a branch, Part XIV imposes what is intended to be a generally comparable tax: in broad terms, any after-tax Canadian earnings that are not reinvested in the corporation's Canadian business are subject to the branch tax.

The branch tax currently applies to every corporation carrying on business in Canada that is not a Canadian corporation. Under subsections 89(1) and 250(5.1) of the Act, a corporation is a Canadian corporation only if it both: (1) is resident in Canada; and (2) was incorporated in (or continued into) Canada or has been resident here since June 18, 1971. As a result, a corporation may be resident in Canada without being a Canadian corporation, and thus be subject to the branch tax.

Subclause 139(1)

ITA
219(1)

Subsection 219(1) of the Act imposes liability to branch tax and describes the tax base. This amendment modifies subsection 219(1) so

that the branch tax applies only to non-residents. The amendment also makes certain changes to the branch tax base.

The opening words of subsection 219(1) are amended to apply the tax only to corporations that are non-resident in a taxation year. It should be noted that the tax may apply to a non-resident corporation whether or not the corporation is carrying on business in Canada, although in most cases only Canadian-source business income and related taxable capital gains will be subject to tax.

The general structure of the branch tax base remains the same: the base is the amount, if any, by which the total of certain amounts, now listed in paragraphs 219(1)(a) through (g), exceeds the total of other amounts, now listed in paragraphs 219(1)(h) through (l). The following notes describe each of these provisions in turn, while the accompanying table shows the relationship between the current and the new rules.

Unless otherwise noted, all paragraphs referred to form part of subsection 219(1).

Table 1

Part XIV base computation under existing and new 219(1)

Existing	Effect	New	Notes
219(1)(a)	Inclusion: amount taxable ("base amount")	219(1)(a)	
(a.1)	Inclusion: dividends deducted under 112	–	Unnecessary - 219(1) applies to non-residents only
(a.2)	Inclusion: dividends deducted under 115	(b)	
(a.3)	Inclusion: amounts deducted under 20(1)(v.1)	(c)	

–	Inclusion: non-taxable portion of gains on TCP used in Canadian business	(d)	New
–	Inclusion: grants, credits, etc. re. amount deducted under (k) (existing (j))	(e)	New
(a.4)	Inclusion: deferred gain on transfer of branch property	(f)	Can now transfer to any "qualified related corporation" – see 219(8)
(b)	Inclusion: previous year's investment allowance	(g)	
(c)	Inclusion: previous year's claim for dividends paid while resident	–	Unnecessary - 219(1) applies to non-residents only
(d)	Deduction: (where non-resident throughout year) net TCG from non-business TCP	–	Unnecessary - new 219(1.1) includes in Part XIV base only gains relating to Canadian business property
(e)	Deduction: federal taxes	(h)	Combines existing (e) and (f)
(f)	Deduction: provincial taxes	(h)	
(f.1)	Deduction: non-deductible tax interest and penalties	(i)	

(g)	Deduction: foreign tax credits	–	Unnecessary - 219(1) applies to non-residents only
(h)	Deduction: investment allowance	(j)	
(i)	Deduction: dividends paid while resident	–	Unnecessary - 219(1) applies to non-residents only
(j)	Deduction: non-deductible Crown royalties, etc.	(k)	
(k)	Deduction: excess of FMV of property transferred over PUC increase + "boot"	(l)	Can now transfer to any "qualified related corporation" – see 219(8)

Inclusions

Paragraph (a), which is substantively unchanged, includes in a non-resident corporation's branch tax base the corporation's taxable income earned in Canada for the year. This amount is cited in several other paragraphs, and is described for the purposes of subsection 219(1) as the corporation's "base amount". Paragraph (b) includes the amount of any dividends deducted because of section 112 and paragraph 115(1)(d.1) of the Act in computing the corporation's base amount. Paragraph (c) includes any amount deducted under paragraph 20(1)(v.1) of the Act, other than a portion of such an amount deductible because of the corporation's membership in a partnership.

New paragraph (d) adds a new inclusion to the branch tax base. In general, the taxable portion of any net gain realized by a non-resident corporation on the disposition of a taxable Canadian property used in a Canadian business will be included in the corporation's base amount. This provision adds to the base the non-taxable portion of any such gain. This further conforms the branch tax to Part XIII of the Act: when a Canadian subsidiary dividends the exempt portion of

its capital gains to its non-resident parent, non-resident withholding tax will normally be imposed.

The other new inclusion in the branch tax base is new paragraph (e). Under the Act, certain royalties, tax payments and deemed proceeds of disposition in respect of natural resources are either included in a taxpayer’s income or not permitted to be deducted. Where such an amount has increased the taxable income earned in Canada of a corporation subject to the branch tax, and is not otherwise deductible in computing the corporation’s branch tax base, paragraph (k) allows the corporation to deduct the amount. In some cases, however, a corporation may receive a grant or credit in respect of such an amount. New paragraph (e) adds these grants and credits to the corporation’s base amount for the year they are received, unless they have already been included in the base amount for that or another year.

Paragraph (f) is triggered by a non-resident corporation’s disposition under paragraph (l) of its Canadian business property to a Canadian corporation. Any excess of the fair market value of the property over the corporation’s proceeds of disposition is included in the corporation’s branch tax base. It should be noted that while the present paragraph (k) requires that the transferee be a subsidiary wholly-owned corporation of the non-resident transferor, paragraph (l) will allow the transferee to be any other "qualified related corporation" as defined in amended subsection 219(8).

Paragraph (g) brings into the branch tax base any "investment allowance" claimed by the corporation under paragraph (j) for the previous taxation year.

Deductions

Paragraphs 219(1)(h) through (l), which describe the deductions available in computing the amount subject to branch tax, are substantively the same as the corresponding provisions in the current subsection 219(1). Paragraph (h) allows a deduction for federal and provincial income taxes payable for the year (as well as for taxes under Parts I.3 and VI of the Act). Since new subsection 219(1.1) excludes from the branch tax base taxable capital gains on non-business property, the deduction in paragraph (h) is reduced by the portion of a corporation’s taxes that may be considered to relate

to such gains. Expressed as a ratio, the deductible portion of the taxes in question is to their total as the corporation's base amount is to the amount that would be its base amount if subsection 219(1.1) did not apply.

Non-deductible interest and penalties paid in the year under the Act or under a provincial income tax law are also deducted from the branch tax base, under paragraph (i). For simplicity these amounts are, unlike taxes, not prorated for the excluded portion of taxable capital gains.

Paragraph (j) provides a deduction for a corporation's "investment allowance". Section 808 of the *Income Tax Regulations* prescribes the amount of a corporation's allowance for a taxation year in respect of its investment in property in Canada: in very broad terms, the allowance is the total of the cost amount of the corporation's Canadian business property and its liquid business assets, less related debts and unpaid tax liabilities. Although its general form will remain unchanged, this Regulation will be revised to reflect the amendment of subsection 219(1) of the Act.

Paragraph (k) allows a corporation to deduct in computing the branch tax base certain royalties, tax payments and deemed proceeds of disposition in respect of natural resources that are non-deductible or are included in income under Part I of the Act. Such an amount may be deducted to the extent it is not already deductible from the base either as a tax or as part of the investment allowance.

If a corporation that is subject to the branch tax transfers property used in its Canadian business to another corporation, that property will cease to figure in the transferor corporation's investment allowance, and the transferor's branch tax liability will increase. To allow a non-resident corporation to switch from carrying on business through a branch to carrying on business through a subsidiary, without facing this increase in its branch tax, paragraph (l) provides a special deduction from the branch tax base.

Three conditions must be met in order to use the paragraph (l) deduction. First, the property disposed of must have been used by the transferor corporation immediately before the disposition for the purpose of gaining or producing income from a business it carried on in Canada. Second, the purchaser of the property must be a Canadian

corporation that was, immediately after the disposition, a qualified related corporation of the transferor. This represents a modification of the current rule, which requires that the purchaser be a subsidiary wholly-owned corporation of the non-resident. Finally, the consideration taken back by the transferor on the disposition must include a share (currently shares) of the purchaser corporation.

Where these conditions are met, the transferor corporation can deduct under paragraph (l) an amount equal to any excess of (i) the fair market value of the transferred property over the total of (ii) any increase in the purchaser's paid-up capital as a result of the disposition, and (iii) the fair market value of any non-share consideration taken back by the transferor. As noted above, at the same time, paragraph (f) includes in the branch tax base any excess of the transferred property's fair market value over the transferor corporation's proceeds of disposition.

The amendments to subsection 219(1) apply to taxation years that begin after 1995. A transitional rule ensures that the provision operates appropriately despite the renaming of its paragraphs. In computing the tax base for a year beginning in 1996, the previous year's investment allowance will normally have been deducted under current paragraph (h), rather than under new paragraph (j). The transitional rule, which applies to taxation years that begin in 1996, therefore adds a reference to paragraph (h) as it read in its application to the 1995 taxation year.

ITA
219(1.1)

Under subsection 219(1) of the Act, a non-resident corporation's taxable income earned in Canada for a taxation year (which the subsection terms the corporation's "base amount") is one of the elements of the corporation's branch tax base. In determining a non-resident's taxable income earned in Canada, paragraph 115(1)(b) of the Act provides that the only taxable capital gains and allowable capital losses to be taken into account are those arising from dispositions of what is defined as "taxable Canadian property" (TCP). New subsection 219(1.1) of the Act restricts the definition of TCP for purposes of computing a non-resident corporation's branch tax base under subsection 219(1). For those purposes, paragraph 115(1)(b) is to be read without reference to subparagraphs (i) and (iii) to (xiii).

This includes in the subsection 219(1) base amount only those gains and losses that arose on capital property used in carrying on the non-resident corporation's business in Canada.

This new provision applies to taxation years that beginning after 1995.

Subclause 139(2)

ITA
219(8)

"qualified related corporation"

Subsection 219(8) of the Act defines the term "qualified related corporation" for purposes of the special treatment of non-resident insurers under Part XIV of the Act. The amendment to this definition extends its application beyond corporations related to insurers, to apply for other purposes of Part XIV as well. This is particularly relevant to the transfer of Canadian business property by a non-resident under amended paragraphs 219(1)(f) and (l), which require that the transfer be to a qualified related corporation.

With this amendment to subsection 219(8), a corporation resident in Canada is a qualified related corporation of a particular corporation if all of its shares (other than directors' qualifying shares) are owned by any one or more of:

- the particular corporation;
- a subsidiary wholly-owned corporation of the particular corporation;
- a corporation of which the particular corporation is itself a subsidiary wholly-owned corporation; or
- a subsidiary wholly-owned corporation of a corporation of which the particular corporation is itself a subsidiary wholly-owned corporation.

The term "subsidiary wholly-owned corporation" of a given corporation, as defined in subsection 248(1) of the Act, includes only

a subsidiary all of the shares of which (other than directors' qualifying shares) are held directly by that corporation. In this context, however, the term has a broader meaning. If C Ltd. is a subsidiary wholly-owned corporation of B Ltd., and B Ltd is itself a subsidiary wholly-owned corporation of A Ltd., then C Ltd. will also be a subsidiary wholly-owned corporation of A Ltd., for the purposes of subsection 219(8).

This amendment applies to taxation years that begin after 1995.

Clause 140

Corporate Emigration

ITA
219.1

Section 219.1 of the Act currently imposes a tax under Part XIV of the Act (commonly known as the "departure tax") where a corporation ceases to be a Canadian corporation. For the 1996 and subsequent taxation years, this amendment to section 219.1 applies the tax not to corporations that cease to be Canadian corporations, but rather to corporations that cease to be resident in Canada. This ensures a better matching of the departure tax and the "branch tax" imposed under subsection 219(1) of the Act and, together with the amendments to that provision (see the commentary on subsection 219(1)), simplifies Part XIV and better conforms it to the general scheme of the Act.

Paragraph 128.1(4)(a) of the Act treats an emigrating corporation's taxation year as having ended immediately before the corporation ceased to be resident in Canada. Under amended section 219.1, such a corporation will be required to pay the 25% departure tax on or before the day it is required to file its income tax return for that taxation year. Under paragraph 128.1(4)(b), the emigrating corporation is also treated as having disposed of all of its property immediately before that deemed year-end for proceeds equal to the property's fair market value. In most cases, the tax under amended section 219.1 is payable on the amount, if any, by which those deemed proceeds, described in paragraph 219.1(a), exceed the total of the paid-up capital in respect of all of the corporation's shares

immediately before year-end (paragraph 219.1(b)) and the corporation's debts and obligations, other than amounts payable in respect of dividends and amounts payable under section 219.1 itself (paragraph 219.1(c)). New paragraph 219.1(d) deducts a further amount in calculating the departure tax base where a corporation has paid tax under subsection 219(1) or section 219.1 for a taxation year that began before 1996. The need for paragraph 219.1(d) and its operation are explained below.

Pre-1996 Part XIV Tax - Paragraph 219.1(d)

The amendments to sections 219 and 219.1 shift the focus of both the subsection 219(1) branch tax and the section 219.1 departure tax in Part XIV of the Act from a corporation's status as a Canadian or other corporation to its residence. In most cases, this change will operate appropriately. In a few special circumstances, however, special relief is necessary to ensure that a corporation is not in effect taxed twice on the same amount.

For example, a corporation that is resident in Canada but not a Canadian corporation may have paid branch tax on any Canadian-source taxable income that was not reinvested in its Canadian business. If the corporation ceases to be resident in Canada after 1995, it will be subject to departure tax on the difference between the fair market value of its property and the total of its paid-up capital and its debts. To avoid taxing surplus on which the corporation has already been taxed under Part XIV, the corporation's departure tax base should be reduced.

Similarly, a corporation that before 1996 ceases to be a Canadian corporation – perhaps by continuing abroad – and then ceases to be resident after 1995 will be subject to departure tax twice (and may be subject to branch tax in the interim as well). Again, the corporation's departure tax base on ceasing to be resident in Canada should be reduced to reflect the amounts on which it has already been taxed.

Paragraph 219.1(d) is intended to accommodate such cases, by applying to any corporation resident in Canada that has paid either the subsection 219(1) branch tax or the section 219.1 departure tax for a taxation year beginning before 1996 and after the corporation last became resident in Canada. In effect, paragraph 219.1(d) reduces the emigrant corporation's departure tax base by the total

of the amounts on which the corporation has paid branch tax or departure tax.

More specifically, paragraph 219.1(d) reduces a corporation's departure tax base by 4 times the total of the amounts that the corporation would have paid under subsection 219(1) or section 219.1 for the years in question if sections 219.2 and 219.3 of the Act and any applicable international agreement or convention did not apply. By multiplying by 4 the (25%) tax that would have been payable but for tax treaties and sections 219.2 and 219.3 (which reduce the rate of Part XIV tax to the relevant treaty rate), the provision establishes the base on which the tax was paid.

Clauses 141 and 142

Administration - Delegation

ITA
220(2.01) and 221(1)

New subsection 220(2.01) is added to the Act to provide that the Minister of National Revenue may administratively delegate the Minister's powers and duties under the *Income Tax Act* or *Income Tax Regulations* to an officer or class of officers in the Department. This new subsection replaces the requirement that such delegation be done by a regulation (Part IX of the *Income Tax Regulations*). This amendment will allow a more timely revision of the delegation of the Minister's powers and duties required by an amendment to the Act or a reorganization within the Department.

As a consequence of the addition of new subsection 220(2.01) to the Act, paragraph 221(1)(f) of the Act, which authorizes the making of regulations to delegate the Minister's powers and duties under the Act or Regulations, is repealed.

These amendments apply on Royal Assent.

Assessments

ITA
220(3.4)

Subsection 220(3.4) of the Act requires the Minister of National Revenue to reassess each taxation year of any taxpayer to take into consideration a late, amended or revoked election permitted by subsection 220(3.2), even if the normal reassessment period for that year has expired. Subsection 220(3.4) is amended strictly as a consequence of the addition of new subsection 152(4.01), and ensures that subsection 220(3.4) operates despite the limitations imposed by new subsection 152(4.01) on the Minister's power to reassess under subsection 152(4) beyond the normal reassessment period. Subsection 220(3.4) applies to elections in respect of the 1985 and subsequent years.

Regulations -
Incorporation by reference

ITA
221(4)

Subsection 221(1) of the Act provides the Governor in Council with regulatory-making powers to carry out the purposes of the Act. For greater certainty, new subsection 221(4) will expressly provide that regulations may give legal effect to documents (either legislative or non-legislative instruments) and other laws not included directly in the *Income Tax Regulations* but that are incorporated as amended from time to time.

This amendment will come into force on Royal Assent and applies to all regulations made under the Act, whether made before, on or after that date.

Clause 143

Court Costs

ITA
222.1

New section 222.1 is added to the Act to ensure that where an amount is payable to Her Majesty because of an order, judgment or award of a court in respect of the cost of litigation relating to a matter to which the Act applies, various relevant provisions of the Act apply to that amount as if it were a debt owing by the person on account of tax payable under the Act. New section 221.1 applies to amounts that are payable after Royal Assent, including where those amounts became payable before Royal Assent.

Clause 144

Collection Restrictions

ITA
225.1(1)

Section 225.1 of the Act imposes certain limits on Revenue Canada's collection of unpaid amounts for which a taxpayer has been assessed under the Act. In general, collection actions are limited for 90 days after the date of assessment, or until any objection or appeal by the taxpayer has been disposed of. Some special assessments, however, cannot be objected to by the taxpayer. These include reassessments under subsections 152(4.2) (to determine a refund or reduction of an amount payable), 169(3) (to dispose of an appeal with the taxpayer's consent), and 220(3.1) (to account for the cancellation of interest or penalties) of the Act. This amendment to subsection 225.1(1) excludes amounts owing under these special provisions from the collection limitations in section 225.1. This amendment applies on Royal Assent.

Clause 145

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 particular persons and entities.

Subclause 145(1)

ITA
227(4) and (4.1)

Subsection 227(4) of the Act provides that amounts withheld from payments made by a payer in respect of taxes payable by the recipient are deemed to be held in trust for Her Majesty separate and apart from the payer's own moneys and give rise to a lien and charge on property of the payer, from the time these amounts are withheld, whether or not they are kept separate and apart and whether or not the payer is in receivership, bankruptcy or liquidation.

Subsection 227(4) is amended effective June 15, 1994 to remove the reference to the lien and charge on the property and assets of the payer. New subsection 227(4.1) will provide that the deemed trust for the amounts withheld from payments, applies to property of the payer equal in value to any such amount deemed to be held in trust and that was not paid to Her Majesty as and when required. In particular, this change purports to ensure that the jurisprudence on the priority status of the deemed trust continues to apply as it did before the June 15, 1994 technical amendments. Similar amendments are made to the *Canada Pension Plan*, the *Unemployment Insurance Act* and a reference to new subsection 227(4.1) of the *Income Tax Act* is added to the deemed trust exception in the *Bankruptcy and Insolvency Act*.

Subclause 145(2)

ITA
227(10)

Subsection 227(10) of the Act empowers the Minister of National Revenue to assess a person for various amounts, including penalties and other amounts payable by the person in respect of the failure to comply with the various provisions of the Act. Subsection 227(10) is amended to apply to a person or partnership that is required to pay a penalty for failure to comply with the reporting requirements in respect of tax shelters under new subsection 237.1(7.4).

This subsection applies after December 1, 1994.

Clause 145.1

Electronic records

ITA
230(4.1) and (4.2)

Subsection 230(1) of the Act compels every person who carries on a business and every person who is required to pay or collect taxes to keep records and books of account. New subsection (4.1) requires a person who keeps records in an electronic format to retain them in that format for the retention period referred to in subsection 230(4). New subsection (4.2) enables the Minister to exempt a person or a class of persons from the requirement to keep their records in an electronic format under such terms and conditions as are acceptable to the Minister.

This amendment applies on Royal Assent.

Clause 145.2

Definitions

ITA
231

"document"

The definition of "document" in section 231 is amended to remove certain items, which are now found in the definition of "record" in subsection 248(1). This amendment applies on Royal Assent.

Clause 145.3

Copies

ITA
231.5(1)

Subsection 231.5(1) permits the making of copies of documents obtained in certain circumstances, and states that the copy made has the same probative force as the original document. This subsection is amended to enable the making of a print-out of an electronic document and sets out that this print-out has the same probative force as the original document.

This amendment applies to copies and print-outs made after Royal Assent.

Clause 146

Solicitor-Client Privilege

ITA
232(3.1)

Subsection 232(3.1) of the Act provides a requirement to set aside and conserve a document in respect of which a lawyer has claimed solicitor-client privilege. This amendment clarifies that this

requirement applies both to a claim made in the course of an on-site inspection under section 231.1 of the Act and to a claim made following a requirement in writing under section 231.2 of the Act. This amendment applies on Royal Assent.

Clause 147

Tax Shelters

ITA
237.1

Section 237.1 of the Act requires promoters of a tax shelter to obtain an identification number from the Minister of National Revenue before selling the tax shelter.

Subclauses 147(1) to (3)

ITA
237.1(1)

Subsection 237.1(1) of the Act provides definitions for the purposes of the tax shelter identification rules. Subsection 237.1(1) is amended to ensure that the definition of:

- "person" includes a partnership;

- "promoter" includes a person who accepts, whether as principal or agent, consideration in respect of a tax shelter; and

- "tax shelter" applies to a property (including, for greater certainty, a right to income) where the amounts represented to be deductible, if a person were to acquire an interest in the property within four years after the day the property is acquired, *equal* or exceed the cost of the property (after the deduction of prescribed benefits).

For the purpose of the definition of "tax shelter", the cost of property is to be determined without reference to new section 143.2 of the Act. Consequential amendments are to be made to section 231 of the *Income Tax Regulations* to ensure that the prescribed benefits include

section 143.2 reductions for any limited-recourse amounts and at-risk adjustments in respect of the taxpayer's expenditure.

The amendments relating to the definitions of "person" and "tax shelter" apply after November 1994, and the amendment relating to the definition of "promoter" applies after December 1, 1994.

Subclause 147(4)

ITA
237.1(4) and (6)

Subsections 237.1(4) and (6) of the Act are amended, applicable after December 1, 1994, consequential on the other amendments to section 237.1 described in these notes.

ITA
237.1(5)

Subsection 237.1(5) requires that the promoters of a tax shelter make reasonable efforts to ensure that the identification number assigned to a tax shelter is provided to every person who acquires an interest in the tax shelter. Subsection 237.1(5) is amended to require that promoters:

- prominently display on the upper right-hand corner of any statement of earnings the identification number for the tax shelter, and

- prominently display a specific "tax shelter statement" on every written statement made after 1995 by the promoter that refers (directly or indirectly and either expressly or impliedly) to the issuance of an identification number for the tax shelter, as well as on copies of the information return.

The above display requirements are analogous to the display requirements in former subsection 231(5) of the *Income Tax Regulations*. This amendment applies after December 1, 1994.

ITA
237.1(6.1)

New subsection 237.1(6.1) of the Act provides that an amount may not be deducted or claimed by any person for any taxation year in respect of a tax shelter where a penalty (and interest thereon) under subsection 162(9) or new subsection 237.1(7.1) has not been paid or, where it has been paid, an amount on account of the penalty (and interest) has been repaid under subsection 164(1.1) or applied under subsection 164(2).

This subsection applies after December 1, 1994.

ITA
237.1(6.2)

New subsection 237.1(6.2) of the Act provides to the Minister of National Revenue the authority to make such assessments, determinations and redeterminations as are necessary to give effect to this subsection 237(6.1). New subsection 237.1(6.2) applies after December 1, 1994.

ITA
237.1(7)

Subsection 237.1(7) of the Act imposes an obligation on promoters to make an information return in respect of tax shelters. Subsection 237.1(7) is amended to make grammatical and reference changes consequential to other amendments to section 237.1.

ITA
237.1(7.1) to (7.3)

New subsection 237.1(7.1) of the Act provides that a tax shelter information return required under new subsection 237.1(7) is required to be filed with the Minister of National Revenue by the end of February of the year after the year in which the tax shelter was acquired. Where, however, the person required to file the information return in respect of a business or activity discontinues that business or activity in a calendar year, new subsection 237.1(7.2) provides that the return in respect of the calendar year is due within 30 days of the discontinuance. Further, new subsection 237.1(7.3) provides that the

filer of such an information return is to forward to each person to whom the return relates two copies of the portion of the return relating to that person. These amendments apply after December 1, 1994.

ITA
237.1(7.4)

New subsection 237.1(7.4) of the Act is analogous to repealed subsection 162(9) of the Act. Subsection 237.1(7.4) imposes a penalty for failure to comply with the reporting requirements in respect of tax shelters under section 237.1. The penalty that applies for failures to comply with reporting requirements is increased from 3% to 25%. This subsection applies after December 1, 1994.

Clause 148

Other Offences and Punishments

ITA
239

Section 239 establishes various offences involving wilful contravention and other contraventions that are considered serious.

Subclause 148(1)

ITA
239(1.1)

Subsection 239(1) of the Act creates an offence for making false statements, altering documents, etc. for the purpose of evading or reducing the tax payable by a person under the Act. It does not cover the situation where no tax is payable by the person but the same things are done for the purpose of obtaining or increasing a refund or credit under the Act. New subsection 239(1.1) creates a new offence for doing those things for the purpose of obtaining or increasing a refund or credit. This amendment applies on Royal Assent.

Subclause 148(2)

ITA
239(2)

Subsection 239(2) of the Act provides that a charge for an offence under subsection 239(1) may be prosecuted by indictment, in which case an accused may be liable to a larger fine or a longer term of imprisonment. The amendment would make subsection 239(2) apply also to charges under new subsection 239(1.1). This amendment applies on Royal Assent.

Subclause 148(3)

ITA
239(3)

Subsection 239(3) of the Act protects a person convicted of an offence under section 239 from being penalized later under sections 162 or 163. The amendment rewords subsection 239(3) to make it clear that it also applies to persons convicted under new subsection 239(1.1). This amendment applies on Royal Assent.

Clause 149

Procedure and Evidence

ITA
244

Section 244 of the Act provides a number of evidentiary and procedural rules dealing with the administration and enforcement of the Act.

Subclause 149(1)

ITA
244(9)

An affidavit may be sworn by an officer who has charge of the appropriate records and, in such cases, a document annexed to an

affidavit is a true copy of a document and is evidence of the nature and contents of the document. Subsection 244(9) is amended, effective on Royal Assent, to give this same effect to a print-out of an electronic document.

Subclause 149(2)

ITA
244(13)

Subsection 244(13) of the Act provides that any document purported to be executed by an officer authorized by regulation to act for the Minister of National Revenue is deemed to have been executed by that officer unless called into question by the appropriate authority. This subsection is amended, as a consequence of the repeal of paragraph 221(1)(f) of the Act and the addition of subsection 220(2.01) to the Act, to replace the reference to a person authorized by regulation with a reference to a person authorized by the Minister.

This amendment applies on Royal Assent.

ITA
244(14)

Subsection 244(14) of the Act provides a rule presuming the date shown on a notice of assessment made by the Minister of National Revenue, or on a notice or notification made by the Minister under certain other provisions of the Act, to be the date of mailing. The scope of this provision is extended so that it also applies in respect of a notice of determination made by the Minister. Subsection 244(14) is also amended by replacing the reference to subsection 152(4) with a reference to subsection 152(3.1) and by adding a reference to subsection 165(3).

Prior to an amendment made to subsection 152(4) of the Act by chapter 39 of the Statutes of Canada, 1990, subparagraph 152(4)(a)(ii) contained a reference to the day of mailing of a notice of assessment or a notification that no tax is payable. As a result of that amendment, the computation of the time limit is now contained in subsection 152(3.1). Subsection 244(14) is therefore amended to refer to subsection 152(3.1) instead of 152(4).

Under subsection 165(3) of the Act, the Minister shall, on receipt of a notice of objection, reconsider an assessment and vacate, confirm or vary the assessment or reassess. The Minister also has to notify in writing the taxpayer of the decision. The provisions of subsection 244(14) apply to a notice of assessment that has been varied under subsection 165(3) or to a reassessment because such notices are caught by the words "notice of assessment" but a notice that confirms an assessment is not. A reference to subsection 165(3) is therefore added to subsection 244(14), so that the date shown on a notice that confirms an assessment and that was sent in accordance with subsection 165(3) is presumed to be the mailing date of the notice.

These amendments to subsection 244(14) apply on Royal Assent.

ITA
244(15)

Subsection 244(15) of the Act provides that a notice of assessment sent by the Minister of National Revenue is deemed to have been made on the day of mailing of the notice of the assessment. The scope of that provision is extended so that it also applies to a notice of determination.

This amendment to subsection 244(15) applies on Royal Assent.

Clause 150

Definitions

ITA
248

Section 248 of the Act defines a number of terms that apply for the purposes of the Act, and sets out various rules relating to the interpretation and application of various provisions of the Act.

Clause 150(1)

"term preferred share"

Subsection 248(1) of the Act contains a definition of "term preferred share". These are shares the dividends on which are denied the intercorporate dividend deduction if received by a specified financial institution in certain circumstances. The definition contains a number of exclusions, including that in paragraph (d.1) for shares issued before April 22, 1980 by a corporation described in any of paragraphs 39(5)(b) to (f) (or an associated corporation) if the shares are listed on a Canadian stock exchange.

Paragraph (d.1) of the definition is amended so that instead of referring to a corporation described in any of paragraphs 39(5)(b) to (f), it refers to a corporation referred to in any of paragraphs (a) to (d) of the definition of "specified financial institution" in subsection 248(1) or a corporation whose principal business is money lending or purchasing debt obligations. This amendment is made as a consequence of amendments to subsection 39(5), and does not change the substance of the exclusion. This amendment applies after February 22, 1994.

Subclause 150(2)

ITA
248(1)

"cemetery care trust"

Subsection 248(1) of the Act is amended to introduce the definition "cemetery care trust". For further information, see the commentary on the new definition in subsection 148.1(1).

This amendment applies after 1992.

"flow-through share"

Subsection 248(1) is amended to add the definition "flow-through share", which has the meaning assigned by subsection 66(15) of the Act. This amendment applies after November 1994.

"majority interest partner"

The new definition "majority interest partner" in subsection 248(1) replaces that formerly found in subsection 97(3.1). The new definition differs in two respects from the existing one. First, it applies on the basis of the entitlement of a member of a partnership to the partnership's income from all sources, rather than that member's entitlement to income from each source. Second, it uses the concept of affiliated persons introduced in new section 251.1 of the Act in its aggregation of various partnership interests.

A person or partnership (the "taxpayer") will be considered to be a majority interest partner of a partnership at any given time where the taxpayer was entitled to more than half of the partnership's income from all sources for the immediately preceding fiscal period (or, where the partnership is in its first fiscal period, for that period), or would be entitled to more than half of the amount paid to all members of the partnership if it were wound up at that time. For the purposes of this rule, a taxpayer will be considered to hold each interest that the taxpayer or an affiliated person held in the partnership. (The concept of affiliated persons has been introduced in new section 251.1 of the Act, and is described in the commentary to that section.)

This definition applies after April 26, 1995.

"record"

Subsection 248(1) is amended to add the definition of record. The definition encompasses a variety of items, whether they are in writing or in any other form. This definition applies on Royal Assent.

"scientific research and experimental development"

The definition "scientific research and experimental development" in subsection 248(1) of the Act is amended to eliminate the cross reference to the definition in Income Tax Regulation 2900(1) and now contains the substantive definition of "scientific research and experimental development". Subsection 2900(1) of the *Income Tax Regulations* is being repealed contemporaneously.

Paragraph (d) of the definition has been amended for greater certainty to emphasize that, in applying the definition to a taxpayer, paragraph (d) includes only work undertaken by or on behalf of the taxpayer with respect to the items included in that paragraph where the work is commensurate with the needs, and directly in support, of work described in paragraph (a), (b), or (c) of the definition that is undertaken in Canada by or on behalf of the taxpayer.

The new definition applies to work performed after February 27, 1995. However, for the purposes of paragraphs 149(1)(j) and 8(b) of the Act, the new definition does not apply to work performed pursuant to an agreement in writing made before February 28, 1995.

Clause 151

International Shipping Corporations

ITA
250(6)

Whether or not a person is resident in Canada for tax purposes is a factual question, subject to several special rules in the Act. One of these rules, in subsection 250(6) of the Act, provides additional certainty as to the residence of an international shipping corporation. Subsection 250(6) treats a corporation formed outside Canada as being throughout a taxation year resident in its country of incorporation and not in Canada, provided certain criteria are met. One requirement, in paragraph 250(6)(a), is that the corporation's principal business in the year be the operation of ships in international traffic. A second, in paragraph 250(6)(b), is that all or substantially all of the corporation's gross revenue for the year be from such operations.

For liability, registry or other reasons, a shipping corporation may place its ships in one or more separate wholly-owned subsidiaries. Revenue from the operation of ships currently does not include dividends from such a subsidiary. Nor does the holding of one or more shipping subsidiaries clearly qualify as the operation of ships in international traffic.

Paragraph 250(6)(a) is amended to treat the holding of shipping subsidiaries as the equivalent, for these purposes, of carrying on a shipping operation directly. More specifically, amended paragraph 250(6)(a) requires that a corporation either meet the principal business test itself, or hold throughout the year shares of one or more wholly-owned corporations, each of which itself meets the tests in subsection 250(6). Provided the total cost amount to the parent corporation of its shares in such subsidiaries is throughout the year at least half the total cost amount of all its property, the parent corporation need not itself meet the principal-business test.

Similarly, paragraph 250(6)(b) is amended to count as international shipping revenue dividends from subsidiary wholly-owned corporations that themselves qualify as non-residents under the provision. Amended paragraph 250(6)(b) requires that all or substantially all of a corporation's gross revenue for the year under consideration be from:

- the operation of ships in transporting passengers or goods in international traffic;

- dividends from one or more subsidiary wholly-owned corporations (as defined by subsection 87(1.4) of the Act), each of which is treated by subsection 250(6) as resident in a country other than Canada throughout each of its taxation years that began after February 1991 (when subsection 250(6) was introduced) and before the last time at which it paid any of those dividends; or

- any combination of the above.

This amendment applies to the 1995 and subsequent taxation years.

Clause 152

Corporations - Control and Share Rights

ITA
251(5)(b)

Subsection 251(5) of the Act sets out rules that apply in deciding under subsection 251(2) of the Act whether persons are related, and

in applying the definition "Canadian controlled private corporation" in subsection 125(7) of the Act. Paragraph 251(5)(b) describes how a person who has any of certain rights is to be treated in determining who controls a corporation. These rights – which may be held under a contract, in equity or otherwise, and may be immediate or future, absolute or contingent – are described in subparagraphs 251(5)(b)(i) and (ii). Those subparagraphs also describe the consequences of holding the rights.

Besides adding a clarifying time reference in the opening words of paragraph 251(5)(b), this amendment adds two new sorts of rights to those listed in the provision. New subparagraph 251(5)(b)(iii) provides that a person who has at any time a right to (or to acquire or control) voting rights in respect of a corporation's shares will be considered to be able to exercise those voting rights at that time. Similarly, new subparagraph 251(5)(b)(iv) provides that a person who has at any time a right to cause the reduction of other shareholders' voting rights will be treated as though those voting rights were so reduced at that time. Neither provision applies to a right that is not exercisable at the time in question because it can be exercised only on an individual's death, bankruptcy or permanent disability.

These amendments apply after April 26, 1995.

Clause 153

Definition of Affiliated Persons

ITA
251.1

New section 251.1 of the Act introduces the concept of "affiliated persons" or persons affiliated with one another. This concept, defined in new subsection 251.1(1), is relevant to a number of other new and amended provisions of the Act, most notably those restricting the realization of losses on certain transfers. New section 251.1 applies after April 26, 1995.

ITA
251.1(1)

"affiliated persons"

In order to understand new subsection 251.1(1)'s definition of "affiliated person," a few rules set out in new subsections 251.1(3) and (4) of the Act for the purposes of that section should be noted at the outset. The most basic of these are that persons are considered to be affiliated with themselves, and that a person includes a partnership. In addition, the word "controlled" is to be read in this context as "controlled, directly or indirectly in any manner whatever."

New paragraph 251.1(1)(a) of the Act provides that two individuals are considered to be affiliated only where they are spouses of one another.

New paragraph 251.1(1)(b) of the Act describes a corporation as being affiliated with three categories of person. The first is a person by whom the corporation is controlled. The second are the members of an affiliated group of persons by which the corporation is controlled. An affiliated group of persons, under new subsection 251.1(2) of the Act, is a group of persons each member of which is affiliated with every other member. The third category are the spouses of persons in either of the first two categories.

EXAMPLE 1 - paragraphs 251.1(1)(a) and (b):

> *F, an individual, controls one corporation ("F Ltd") alone, and controls a second corporation ("FG Ltd") as a member of a group that consists of F and G, another individual. F is a spouse of a third individual, M, but not of G.*
>
> *F and M are affiliated persons under paragraph 251.1(1)(a). F Ltd is affiliated with F under subparagraph 251.1(1)(b)(i), and with M under subparagraph (iii). Since F and G are not affiliated with one another (and are thus not an affiliated group), FG Ltd is not affiliated with either F or G.*

Where a corporation is controlled by another corporation, or by an affiliated group that includes a corporation, new paragraph 251.1(1)(b) will treat the two corporations as being

affiliated with one another. New paragraph 251.1(1)(c) of the Act lists several additional circumstances under which two corporations are affiliated persons. In the first of these, in subparagraph (c)(i), each corporation is controlled by a person, and those controlling persons are affiliated with one another. Similarly, where one corporation is controlled by a person and the other corporation is controlled by a group of persons, the two corporations are affiliated under subparagraph (c)(ii) if each member of that group is affiliated with the person controlling the first corporation. Finally, under subparagraph (c)(iii) corporations that are controlled by groups of persons are affiliated if each member of each group is affiliated with at least one member of the other group.

It should be noted that the references in paragraph 251.1(1)(c) to groups of persons are not confined to affiliated groups of persons.

EXAMPLE 2 - subparagraphs 251.1(1)(c)(i) and (ii):

> *A Ltd, B Ltd, C Ltd and D Ltd are corporations. A Ltd is controlled by K, an individual. B Ltd is controlled by Q, K's spouse. C Ltd is controlled by a group made up of K and Q, and D Ltd is controlled by a group made up of B Ltd and C Ltd.*
>
> *Since K and Q are affiliated, A Ltd and B Ltd are affiliated under subparagraph 251.1(1)(c)(i). A Ltd and C Ltd are affiliated under subparagraph (c)(ii), as are B Ltd and C Ltd. D Ltd is affiliated with B Ltd and C Ltd – the members of an affiliated group that controls D Ltd – under subparagraph 251.1(b)(ii). Are A Ltd and D Ltd affiliated? B Ltd and C Ltd are each affiliated with K, because K and Q form the affiliated group that controls both companies. Under subparagraph (c)(ii), therefore, A Ltd and D Ltd are affiliated.*

EXAMPLE 3 - subparagraph 251.1(1)(c)(iii):

> *H, D and L, three individuals, control HDL Ltd as a group. J, E and M are spouses of H, D and L respectively, and control JEM Ltd as a group. Under subparagraph 251.1(c)(iii), HDL Ltd and JEM Ltd are affiliated, because each member of each group is affiliated with at least one member of the other group.*

New paragraph 251.1(1)(d) of the Act specifies a circumstance, in addition to those addressed elsewhere in subsection 251.1(1), in which a corporation and a partnership are affiliated. Where a corporation is controlled by a group of persons each member of which is affiliated with at least one member of a majority-interest group of partners of a partnership (as defined in new subsection 251.1(2) of the Act), and each member of that majority-interest group of partners is affiliated with at least one member of the group that controls the corporation, the corporation and the partnership are affiliated under paragraph (d). This rule resembles the rule in subparagraph 251.1(1)(c)(iii), described above.

Additional specific rules regarding the affiliations of partnerships are provided in new paragraphs 251.1(1)(e) and (f) of the Act. Under paragraph (e), a partnership and a majority-interest partner of the partnership are affiliated with one another. In determining whether a person is a majority-interest partner of a partnership, the new definition of "majority-interest partner" in subsection 248(1) of the Act looks not only to that person's interest, if any, in the partnership, but also to the interests of all persons affiliated with that person. In effect, then, any person affiliated with a person who holds a majority interest in a partnership is also a majority-interest partner, and thus is affiliated with the partnership under paragraph 251.1(1)(e).

Paragraph 251.1(1)(f) provides a set of rules for partnerships broadly comparable to those established for corporations in paragraph 251.1(1)(c). Two partnerships are affiliated under paragraph (f) if any of three situations obtains. First, under subparagraph (f)(i) the partnerships are affiliated if the same person is a majority-interest partner of both partnerships. Second, under subparagraph (f)(ii) the partnerships are affiliated if a majority-interest partner of one is affiliated with each member of a majority-interest group of partners of the other. Lastly, where there is a majority-interest group of partners of each partnership (or more than one such group), the partnerships are affiliated under subparagraph (f)(iii) if each member of a group of each partnership is affiliated with at least one member of a group of the other partnership.

The possibility that a partnership may have more than one majority-interest group of partners means that the interests of all

partners – and of all persons affiliated with a partner – must be carefully considered in order to establish whether two partnerships (or a partnership and a corporation) are affiliated.

ITA
251.1(2)

New subsection 251.1(2) of the Act provides a special rule for the affiliation of corporations in relation to an amalgamation or merger. Where two or more corporations amalgamate or merge to form a new corporation, that new corporation and a predecessor corporation will in certain cases be treated as having been affiliated with one another. This deemed affiliation will arise where the new corporation and the predecessor would have been affiliated if the new corporation had existed before the amalgamation or merger, and if it had the same shareholders at that time as it had after the merger.

ITA
251.1(3)

New subsection 251.1(3) of the Act sets out several special definitions relevant to the definition "affiliated persons" in new subsection 251.1(1) of the Act. Each of these special definitions applies for the purposes of section 251.1.

"affiliated group of persons"

An affiliated group of persons is a group of persons each member of which is affiliated with every other member.

"controlled"

Under subsection 256(5.1) of the Act, the expression "controlled, directly or indirectly in any manner whatever" is given a particular meaning, commonly referred to as "de facto control". The definition of the word "controlled" in new subsection 251.1(2) imports this de facto control test into section 251.1.

"majority-interest group of partners"

A majority-interest group of partners of a partnership is any group of partners that meets two criteria. First, the partnership interests of the

group members must be such that if one person held all of those interests, that person would be a majority-interest partner of the partnership. Second, there must be no subset of the group of which that would be true: it must be the case, in other words, that if the interest of any member of the group were set aside, and the remaining group members' interests were held by one person, that person would not be a majority-interest partner of the partnership.

EXAMPLE 4 - majority-interest group of partners:

> *5 partners each hold a 20% interest in a partnership. In this case, any group of 3 partners is a majority-interest group of partners of the partnership. A group of fewer than 3 will not represent interests that would, if they were held by one person, make that person a majority-interest partner, and thus will not meet the first criterion. A group of more than 3 will not meet the second criterion, since even if one member's interest were ignored, the interests of the remaining group members would, if held by one person, make that person a majority-interest partner.*

ITA
251.1(4)

New subsection 251.1(4) of the Act sets out two rules relevant to the definition "affiliated persons" in new subsection 251.1(1) of the Act. These rules, which are also described in the commentary to that subsection, provide (for the purposes of section 251.1 of the Act) that persons are affiliated with themselves and that a person includes a partnership.

Clause 154

Meaning of Spouse

ITA
252(4)

Subsection 252(4) of the Act provides that the term "spouse" of a taxpayer generally includes a person of the opposite sex who has been cohabiting in a conjugal relationship with the taxpayer for at least twelve months or who is a parent of a child of whom the

taxpayer is also a parent. This amendment to subsection 252(4), which applies after 1992, ensures that the parental relationship in this case extends only to the parent's own children, and not, for example, to daughters-in-law or sons-in-law.

Clause 155

Acquisition of Control of a Corporation

ITA
256

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

Subclause 155(1)

ITA
256(6)

The portion of subsection 256(6) of the Act after paragraph (*b*) is amended to delete the reference to "for the purposes of that provision", as the opening portion of that subsection no longer specifies that the rule it contains applies "for the purposes of any provision of this Act". This amendment applies on Royal Assent.

Subclause 155(2)

ITA
256(7)

The opening words of subsection 256(7) are amended to add references to subsections 10(10), 13(21.2) and (24), 14(12), 18(15) and 40(3.4) of the Act, and the definition "superficial loss" in section 54 of the Act. After April 26, 1995, subsection 256(7) will apply to these provisions in addition to those to which it currently applies.

Subclauses 155(3) and (4)

ITA
256(7)

Subsection 256(7) of the Act describes the circumstances where control of a corporation is considered not to have been acquired, and certain circumstances where control of a corporation is considered to have been acquired, for the purposes of various provisions of the Act.

Subparagraph 256(7)(a)(ii) provides that control of a particular corporation or a corporation controlling it will not be considered to have been acquired because of a redemption or cancellation of shares where each person or each member of a group of persons that controls the corporation after the redemption or cancellation was related to the corporation immediately before the redemption or cancellation.

Subparagraph 256(7)(a)(ii) is amended, applicable to the 1994 and subsequent taxation years, in two ways. First, the amendments provide that a change in the rights, privileges, restrictions or conditions attaching to shares of the corporation or of a corporation that controls it will not result in an acquisition of control in circumstances set out in this subparagraph. Second, the amendments modify the circumstances in which these events will not result in an acquisition of control. **Each** person and each member of **each** group of persons that controls the corporation after the redemption or cancellation of shares or the change in the rights, privileges, restrictions or conditions attached to the shares must be related to the corporation

- immediately before purchase, cancellation or change, or

- immediately before the death of a person where the shares were held immediately before the purchase, cancellation or change by an estate that acquired them on the death of a person.

Where there has been a merger of two or more corporations to form a new corporation, existing paragraph 256(7)(b) generally deems control of a predecessor corporation to have been acquired if the person or group of persons who control the new corporation did not control the predecessor corporation immediately before the

amalgamation. This paragraph is amended to provide that control of a corporation is considered not to have been acquired solely because of an amalgamation unless it is deemed by either of two new rules, set out in subparagraphs 256(7)(b)(ii) and (iii), to have been acquired. The first of these rules, in subparagraph 256(7)(b)(ii), replicates existing paragraph (b). Where a person or group of persons controls the new corporation and did not control a predecessor corporation, that person or group is treated as having acquired control of that predecessor, and of any corporation it controlled before the amalgamation. An exception provides that this deemed acquisition of control will not apply if, had the person or group acquired all the shares of the predecessor before the amalgamation, the person or group would not have acquired control of the predecessor. This ensures that subparagraph 256(7)(b)(ii) does not deem an acquisition of control in certain internal reorganizations of corporate groups.

The second rule, in subparagraph 256(7)(b)(iii), deems control of a predecessor corporation and of each corporation controlled by it before the merger to have been acquired by a (hypothetical) person or group of persons unless

- the predecessor corporation was related, immediately before the merger, to each other predecessor corporation, or

- if one person had (again hypothetically) acquired all the shares of the new corporation received by shareholders of the predecessor corporation (or of another predecessor that controlled that predecessor) on the merger in consideration for their shares of the predecessor corporation (or the other predecessor, as the case may be), that person would have acquired control of the new corporation, or

- subparagraph 256(7)(b)(iii) would otherwise deem control of every predecessor to have been acquired, in an amalgamation of two corporations and their controlled subsidiaries – as it would, for example, if two corporations of equal value amalgamated, with the shareholders of each taking back half the shares of the new corporation.

Amended paragraph 256(7)(b) of the Act applies to mergers occurring after April 26, 1995, except in certain specific circumstances. The amendment may also apply to a merger that occurred after 1992 and

before April 26, 1995, where the corporation formed on the merger so elects within six months of Royal Assent to the amendment.

New paragraph 256(7)(c) of the Act deals with reverse takeover transactions which are illustrated by the following examples.

EXAMPLE A:

> *An individual, Mr. X, owns all the shares of a corporation (Lossco) which have a total fair market value of $100,000. A profitable public corporation (Pubco) that is not controlled by any person or group of persons wishes to gain access to Lossco's non-capital loss carryforward. If Pubco were to acquire the shares of Lossco from Mr. X, various stop-loss rules in the Act would limit the deductibility of those losses. Instead, the shareholders of Pubco transfer their shares of Pubco to Lossco in exchange for shares of Lossco worth $10,000,000. Mr. X relinquishes control of Lossco as a result of the exchange.*

EXAMPLE B:

> *Assume the same facts as in example A except that, instead of transferring their shares of Pubco to Lossco in a share-for-share exchange, the shareholders of Pubco receive shares of Lossco in consideration for the disposition of their shares of Pubco on a triangular amalgamation or merger of Pubco and a wholly owned subsidiary of Lossco.*

In each of these examples, there is no acquisition of control of Lossco under the existing rules unless there is a group of shareholders that controls Lossco after the takeover. However, if new paragraph 256(7)(c) were applied to each of these examples, control of Lossco would be considered to have been acquired by a person or group of persons because the shares of Lossco issued to the shareholders of Pubco in each case are such that, if they had been acquired by one person, that person would have acquired control of Lossco. This paragraph applies to mergers that occur after April 26, 1995 except in certain specified circumstances.

New paragraph 256(7)(d) provides that no acquisition of control of a corporation will be considered to have occurred solely because of a share-for-share exchange where the person or group of persons who

controlled the corporation before the exchange still controls it after the exchange. This paragraph applies to exchanges that occur after April 26, 1995.

New paragraph 256(7)(e) provides that no acquisition of control of a particular corporation will be considered to have occurred solely because of an exchange of shares of the particular corporation for shares of the acquiring corporation when the acquiring corporation is not controlled by a person or group of persons immediately after the exchange and the fair market value of the shares of the particular corporation is not less than 95% of the fair market value of the assets of the acquiring corporation. Subject to specified grandfathering, new paragraph 256(7)(e) of the Act applies to exchanges that occur after April 26, 1995.

Subclause 155(5)

ITA
256(8)

Subsection 256(8) of the Act extends the circumstances in which an acquisition of control is considered to have occurred for the purposes of a number of provisions of the Act. If a taxpayer acquires a right referred to in paragraph 251(5)(b) of the Act with respect to shares, and it can reasonably be concluded that one of the main purposes of acquiring the right is to avoid any of certain rules that are triggered by an acquisition of control, subsection 256(8) will apply. In its current form the subsection treats the taxpayer, for the purposes of determining whether control of the corporation has been acquired, as having acquired the shares.

This amendment modifies subsection 256(8) in three respects. First, subsections 10(10), 181.1(7) and 190.1(6) of the Act are added to the list of rules whose avoidance will trigger the provision, and for the purposes of which it will apply. Subsection 181.1(7) limits the unused surtax credit that a corporation may deduct in computing its tax liability under Part I.3 of the Act after it has undergone an acquisition of control. Subsection 190.1(6) similarly limits a financial institution's deduction of unused Part I tax credits and unused surtax credits.

Second, new paragraph 256(8)(d) provides that a share acquisition intended to avoid the application of new section 251.1 of the Act will trigger subsection 256(8). Section 251.1 defines "affiliated persons" for the purposes of the Act – a definition applying in particular with respect to certain transfers giving rise to losses.

Third, the effect of subsection 256(8) is broadened, to correspond to an amendment to paragraph 251(5)(b). Under that amendment a right to affect the voting rights of shares is treated comparably to a right to acquire the shares themselves or to force their redemption. Amended subsection 256(8) therefore treats the taxpayer as having exercised the right in question, rather as having acquired the shares.

This amendment applies after April 26, 1995,

ITA
256(8.1)

Certain corporations, such as mutual insurers and some non-profit entities, are organized without share capital. New subsection 256(8.1) of the Act ensures that subsections 256(7) and (8) of the Act apply appropriately to such corporations. For the purposes of those subsections, a corporation without share capital is treated as having a single class of shares, and each participant in the corporation is treated as having an appropriate number of those shares, having regard to the total number of participants and the nature of their participation.

New subsection 256(8.1) applies after April 26, 1995.

Clause 156

Coming-into-force: loss deferral

This legislation includes a number of amendments to the Act to consolidate, simplify and improve the rules that defer losses that would otherwise arise on certain transfers of property. Those amendments generally apply to dispositions after April 26, 1995. Section 156 of this Act sets out certain exceptions to that effective date.

First, dispositions that occurred before 1996 pursuant to written obligations made on or before April 26, 1995, are not subject to the new loss-deferral rules.

Second, a disposition is also not subject to the new rules if it, or a series of transactions of which it formed a part, was substantially advanced before April 27, 1995 (unless the transaction or series was intended to give an unrelated person access to a deduction or a balance of undeducted outlays, expenses or other amounts).

For these purposes, a person will not be considered obliged to acquire a property where the person may be excused from fulfilling the obligation because of any change to the Act or because of any adverse assessment made under the Act.

If a transferor who would otherwise be subject to either of these exceptions would nonetheless prefer to have the new rules apply to its disposition, the transferor may obtain that result by filing an election with the Minister of National Revenue before the end of the third month following the month in which this Act is assented to. It should be noted that such an election cannot be made in respect of only some of the listed amendments: if it is made, the election applies all of the new rules to the given transaction.

Clause 157

Depreciable Property - Transitional Rules

Income Tax Application Rules
20(1)

Subsection 20(1) of the *Income Tax Application Rules* (the "Rules") is designed to prevent the taxation of gains on depreciable property that accrued to December 31, 1971 (referred to as "valuation day"). This is achieved by providing that, where a taxpayer’s capital cost of the depreciable property at the time of disposition is less than its fair market value on valuation day and less than the proceeds of disposition, the taxpayer’s proceeds of disposition, for the purposes of section 13 of the amended Act and subdivision c of Division B of Part I of the Act (the subdivision that deals with capital gains and losses), will be the amount that is equal to the total of its capital cost

to the taxpayer and the amount by which the proceeds of disposition exceed the fair market value of the property on valuation day. Where the taxpayer elects under subsection 110.6(19) of the Act in respect of depreciable property, the taxpayer is deemed by that subsection to have disposed of the property for proceeds of disposition equal to the amount designated in the election in respect of the property. If that property were owned by the taxpayer without interruption since before 1972, the proceeds so determined are reduced by paragraph 20(1)(a) of the Rules. In turn, under paragraph 20(1)(c) of the Rules the taxpayer is treated for the purposes of the Act (other than for certain specified purposes such as, paragraphs 8(1)(j) and (p) and sections 13 and 20 of the Act) to have reacquired the property at a capital cost equal to the taxpayer's proceeds of disposition determined under paragraph 20(1)(a) of the Rules.

Paragraph 20(1)(c) of the Rules is amended, applicable to the 1994 and subsequent taxation years, to provide that, where a taxpayer has designated an amount for the election under subsection 110.6(19) of the Act that does not exceed 110% of the fair market value of the property on February 22, 1994, the taxpayer is treated for the purposes of the Act (other than for the purposes of paragraphs 8(1)(j) and (p) and sections 13 and 20 of the Act) to have reacquired the property at a capital cost equal to the taxpayer's proceeds of disposition determined under paragraph 20(1)(a) of the Rules minus the amount by which the designated amount exceeds the fair market value of the property on February 22, 1994. In addition, paragraph 20(1)(c) of the Rules is amended, applicable to the 1994 and subsequent taxation years, to ensure that where a taxpayer elects under subsection 110.6(19) of the Act beyond 110% of the fair market value of the property on February 22, 1994 the capital cost of the property on its reacquisition will be equal to the cost after the reacquisition determined under subsection 110.6(19) of the Act minus the valuation day "tax-free zone". This latter amendment ensures that the same penalty results on the subsequent disposition of the property as would have resulted if the property were not subject to the Rules.

Clause 158

Income Tax Application Rules

Subclause 158(1)

Non-arm’s Length Dispositions

Income Tax Application Rules
26(5)

Subsection 26(5) of the Rules is relevant for the purposes of computing the adjusted cost base of certain capital property held by a taxpayer (or a non-arm’s length person) at the end of 1971. This rule has the effect of ignoring any increases in the adjusted cost base of such property arising because of the operation of the stop-loss rules in paragraphs 40(2)(e), (e.1) and (e.2) and subsection 85(4) of the Act. Paragraph 40(2)(e) and 85(4) are being repealed, and subsection 26(5) of the Rules is thus being amended to ensure that it refers to those provisions as they read prior to their repeal. Reference is also being added to new subsection 40(3.3) of the Act, which largely replaces subsection 85(4) insofar as the latter provision applied to non-depreciable capital property.

Subclause 158(2)

Income Tax Application Rules
26(30)

Subsections 26(1.1) to (29) of the Rules generally relate to the computation of a taxpayer’s gain or loss on property the taxpayer held on December 31, 1971. New subsection 26(30) provides that these rules do not apply to a non-resident’s disposition of a property that has become a taxable Canadian property because of amendments to the Act that take effect on April 26, 1995. Gains and losses on such property are computed according to a special proration rule in new subsection 40(9) of that Act, rather than according to these provisions of the Rules. New subsection 26(30) applies to dispositions that occur after April 26, 1995.

Clause 159

Deemed Trusts

Bankruptcy and Insolvency Act
67(3)

Subsection 67(3) of the *Bankruptcy and Insolvency Act* provides exceptions to the limitations against statutory deemed trusts in case of bankruptcy. The amendment to subsection 67(3) is consequential on the amendment to subsection 227(4) and the addition of subsection 227(4.1) of the *Income Tax Act* described in subclause 148(1). This amendment comes into force on June 15, 1994.

Clause 160

Delegation

Canada Pension Plan
5(2)

New subsection 5(2) is added to the *Canada Pension Plan* to provide that the Minister of National Revenue may administratively delegate powers and duties of that Minister under the *Canada Pension Plan* to an officer or class of officers in the Department. This new subsection replaces the requirement that such delegation be done by a regulation under subsection 40(2) of the Plan. This amendment will allow a more timely revision of the delegation of the Minister's powers and duties required by an amendment to the Act or a reorganization within Revenue Canada and is consequential to similar amendments to the Income Tax Act. This amendment applies on Royal Assent.

Clause 161

CPP Withholding

Canada Pension Plan
23(3) and (4)

Subsection 23(3) of the *Canada Pension Plan* provides for a deemed trust in respect of amounts deducted by an employer from the remuneration of an employee on account of CPP contributions. The amendment to this subsection is similar to the amendment to subsection 227(4) of the *Income Tax Act* described in subclause 148(1). This amendment comes into force on June 15, 1994.

Clause 161.1

Electronic records

Canada Pension Plan
24(2.1) and (2.2)

Subsection 24(1) of the *Canada Pension Plan* requires every employer paying remuneration to an employee employed by the employer in a pensionable employment to keep records and books of account. New subsection (2.1) requires an employer who keeps records in an electronic format to retain them in that format for the retention period referred to in subsection 24(2). New subsection (2.2) enables the Minister to exempt an employer or a class of employers from the requirement to keep their records in an electronic format under such terms and conditions as are acceptable to the Minister.

These amendments apply on Royal Assent.

Clause 161.2

Copies as evidence

Canada Pension Plan
25(12)

Subsection 25(12) permits the making of copies of documents obtained in certain circumstances, and states that the copy made has the same probative force as the original document. This subsection is amended to enable the making of a print-out of an electronic document and sets out that this print-out has the same probative force as the original document.

This amendment applies to copies and print-outs made after Royal Assent.

Clause 162

Tax Court of Canada Act

Subclause 162(1)

Appeal to Tax Court of Canada

Canada Pension Plan
28

Current subsection 28(1) of the *Canada Pension Plan* provides that an appeal to the Tax Court of Canada of a determination by, or of a decision on an appeal to, the Minister of National Revenue in respect of the liability for an employer or an employee to make a contribution under that Act, or as to the amount of such contribution, may be made solely by registered mail. The amendment broadens the available methods in which an appeal may be filed by providing that appeals made under that subsection be governed by the *Tax Court of Canada Act*.

The amendment will come into force on a day to be fixed by order of the Governor in Council to allow for that amendment to be in force simultaneously with the amendments made to the *Tax Court of*

Canada Act in this Bill (see relevant notes in clauses 174 to 181) and new provisions that the Rules Committee will have to make to the *Tax Court of Canada Rules of Procedure respecting the Canada Pension Plan* in order to broaden the means by which an appeal may be filed.

Subclause 162(2)

Reasons for Decisions

Canada Pension Plan
28(2)

Subsection 28(2) of the *Canada Pension Plan* provides that when the Tax Court of Canada hears an appeal made by an employee or an employer affected by a determination by, or a decision on an appeal to, the Minister under section 27 of that Act, the Tax Court must notify in writing the parties to the appeal of the reasons for its decision. In order to achieve greater procedural harmonization between income tax and Canada pension plan matters, this amendment removes the obligation on the Tax Court to provide written reasons for its decision. Subsection 28(2) will therefore be similar, in that respect, to section 18.23 of the *Tax Court of Canada Act*, which governs appeals under the *Income Tax Act* that are subject to the informal procedure.

This amendment applies on Royal Assent.

Clause 163

Regulations for Delegation

Canada Pension Plan
40(2)

Subsection 40(2) of the *Canada Pension Plan* authorizes the making of regulations to delegate the powers and duties of the Minister of National Revenue under Part I of that Act. This subsection is repealed because of the addition of new subsection 5(2) to the Plan, which allows for the delegation of powers and duties of the Minister on an administrative basis. This amendment applies on Royal Assent.

Clause 164

Provision of Information

Canada Pension Plan
104(4.1)

Subsection 104(4.1) of the *Canada Pension Plan* allows for the provision of information obtained pursuant to that Act or any regulation to any officer, clerk or employee of the Department of National Health and Welfare for the purposes of the administration of certain Acts. The subsection is amended, applicable after August 27, 1995, to delete references to the *Children's Special Allowances Act* and the *Income Tax Act* as a result of the transfer of the eligibility portion of the child tax benefit program to the Department of National Revenue.

Clause 165

Definitions

Children's Special Allowances Act
2

"Minister"

The definition of Minister in section 2 of the *Children's Special Allowances Act* is changed to the Minister of National Revenue, applicable after August 27, 1995, as a result of the transfer of the administration of this Act from the Department of National Health and Welfare to the Department of National Revenue.

Clause 166

Provision of Information

Children's Special Allowances Act
10(2)

Subsection 10(2) of the *Children's Special Allowances Act* (CSA) allows for the provision of information obtained by the Department of National Health and Welfare in the course of the administration of that Act and the regulations or the carrying out of an agreement entered into under section 11 of that Act, to various departments. The subsection is being amended to delete the reference to the Department of National Health and Welfare as the Department of National Revenue will be responsible for the administration of that Act. In addition, the subsection is amended to remove the list of Departments which receive information under that Act and will now restrict the communication of information to any person who needs the information for the purposes of the administration of that Act or the *Income Tax Act*.

These amendments apply after August 27, 1995.

Clause 167

Agreements with Provinces

Children's Special Allowances Act
11

Section 11 of the *Children's Special Allowances Act* allows the Minister of Health and Welfare to enter into agreements with the provinces for the exchange of information. The section is amended, applicable after August 27, 1995, to remove the reference to the Department of National Health and Welfare as a result of the transfer of the administration of this Act to the Department of National Revenue.

Clause 168

Issuance of Permits

Cultural Property Export and Import Act
39

Section 39 of the *Cultural Property Export and Import Act* empowers the Governor in Council, on the recommendation of the Minister of Heritage and the Secretary of State for External Affairs, to make regulations to deal with a number of matters. Paragraph 39(a) allows regulations to be made to deal with the issuance of permits under that Act.

The federal budget of 1990 provided that the fair market value, for purposes of the *Income Tax Act*, of objects proposed to be donated to certain institutions be determined by the Canadian Cultural Property Export Review Board. Amendments were made to both the *Income Tax Act* and the *Cultural Property Export and Import Act* to implement this measure.

This amendment to paragraph 39(a), which is consequential on those previous amendments, is intended to ensure that, in making such determinations and issuing certificates, the Canadian Cultural Property Export Review Board may obtain information, documentation and undertaking from applicants, and may establish procedure and conditions to be followed as is necessary to their mandate.

This amendment is effective as of Royal Assent.

Clause 169

Delegation

Customs Act
2(4)

New subsection 2(4) is added to the *Customs Act* to provide that the Minister of National Revenue may administratively delegate powers and duties of the Minister under that Act to an officer or class of officers in Revenue Canada. This new subsection replaces the

requirement that such delegation be done by a regulation under section 134 or paragraph 164(1)(a) of that Act. This amendment will allow a more timely revision of the delegation of powers and duties of the Minister required by an amendment to that Act or a reorganization within Revenue Canada and is consequential to similar amendments to the *Income Tax Act*. This amendment applies on Royal Assent.

Clause 170

Ministerial Order for Delegation

Customs Act
134

Section 134 of the *Customs Act* authorizes the Minister of National Revenue to delegate powers and duties of the Minister under sections 131 to 133 of that Act by Ministerial order. This section is repealed because of the addition of new subsection 2(4) to that Act, which allows for the delegation of powers and duties of the Minister on an administrative basis. This amendment applies on Royal Assent.

Clause 171

Regulations for Delegation

Customs Act
164(1)(a)

Paragraph 164(1)(a) of the *Customs Act* authorizes the making of regulations to delegate powers and duties of the Minister of National Revenue under that Act. This paragraph is repealed because of the addition of new subsection 2(4) to that Act, which allows for the delegation of powers and duties of the Minister on an administrative basis. This amendment applies on Royal Assent.

Clause 171.1

Definitions

Excise Tax Act
2

Section 2 of the *Excise Tax Act* is amended to add a definition of "document" and of "record". These definitions are made to parallel the definitions under Part IX of that Act. These amendments apply on Royal Assent.

Clause 171.2

Records and books of account

Excise Tax Act
20.2(2)

Subsection 20.2(2) of the *Excise Tax Act* requires each licensed carrier that is required to make a return of the amounts described in paragraph 20(1)(b) to keep records and books of account. This subsection is amended to add a reference to new subsection 98(2.01), which deals with the retention of electronic records. These amendments come into force on Royal Assent.

Clause 172

Excise Tax on Split-run Editions of Periodicals

Excise Tax Act
38.1

In December 1995 the Excise Tax Act was amended to impose an excise tax on split-run editions of periodicals. The tax is payable by either the publisher, a person related to the publisher, the distributor, the printer or the wholesaler of the periodical. The taxpayer is the first person on this list who is resident in Canada.
Some concern has been expressed that periodical distributors, printers and wholesalers could face a tax liability on an issue before they are

reasonably able to determine whether a particular periodical is a split-run periodical. To give potential taxpayers more time to become aware of new split-run titles before incurring tax liability, new section 38.1 of the Act exempts from the tax the first split-run issue of a periodical if the person who would otherwise be responsible for paying the tax is the distributor, printer or wholesaler. This exemption will apply to periodicals published after March 6, 1996.

Clause 172.1

Electronic records

Excise Tax Act
98(2.01) and (2.02)

Subsection 98(1) of the *Excise Tax Act* compels every person who is required to pay or collect taxes or other sums or to affix or cancel stamps, or every person who makes an application under any of sections 68 to 70, to keep records and books of account. New subsection (2.01) requires a person who keeps records in an electronic format to retain them in that format for the retention period referred to in subsection 98(2). New subsection (2.02) enables the Minister to exempt a person or a class of persons from the requirement to keep their records in an electronic format under such terms and conditions as are acceptable to the Minister.

This amendment applies on Royal Assent.

Clause 172.2

Copies

Excise Tax Act
100(1.1)

Subsection 100(1.1) of the *Excise Tax Act* permits the making of copies of documents obtained in certain circumstances. This subsection is amended to enable the making of a print-out of an electronic document and sets out that this print-out, as well as a copy

of any document, is evidence of the nature and content of the original document and has the same probative force as the original document.

This amendment applies to copies and print-outs made after Royal Assent.

Clause 172.3

Proof of documents

Excise Tax Act
105(5)

An affidavit may be sworn by an officer who has charge of the appropriate records and, in such cases, a document annexed to an affidavit is a true copy of a document and is evidence of the nature and contents of the document. Subsection 105(5) of the *Excise Tax Act* is amended to give this same effect to a print-out of an electronic document. This amendment applies on Royal Assent.

Clause 172.4

Definitions

Excise Tax Act
123(1)

Subsection 123(1) of the *Excise Tax Act* is amended to add various items to the definition of record, and states that these items may be in writing or in any other form. These amendments apply on Royal Assent.

Clause 172.5

Electronic records

Excise Tax Act
286(3.1) and (3.2)

Subsection 286(1) of the *Excise Tax Act* compels every person who carries on a business or is engaged in a commercial activity in Canada, every person who is required under Part IX of that Act to file a return and every person who makes an application for a rebate or refund to keep records and books of account. New subsection (3.1) requires a person who keeps records in an electronic format to retain them in that format for the retention period referred to in subsection 286(3) of that Act. New subsection (3.2) enables the Minister to exempt a person or a class of persons from the requirement to keep their records in an electronic format under such terms and conditions as are acceptable to the Minister.

This amendment applies on Royal Assent.

Clause 172.6

Copies

Excise Tax Act
291(1)

Subsection 291(1) of the *Excise Tax Act* permits the making of copies of documents obtained in certain circumstances, and states that the copy made has the same probative force as the original document. This subsection is amended to enable the making of a print-out of an electronic document and sets out that this print-out has the same probative force as the original document.

This amendment applies to copies and print-outs made after Royal Assent.

Clause 172.7

Proof of documents

Excise Tax Act
335(5)

An affidavit may be sworn by an officer who has charge of the appropriate records and, in such cases, a document annexed to an affidavit is a true copy of a document and is evidence of the nature and contents of the document. Subsection 335(5) is amended to give this same effect to a print-out of an electronic document. This amendment applies on Royal Assent.

Clause 173

Provision of Information

Old Age Security Act
33(2)(c)

Paragraph 33(2)(c) of the *Old Age Security Act* allows for the provision of information obtained pursuant to the *Old Age Security Act* or the regulations to any officer or employee of the Department of National Health and Welfare for the purposes of the administration of certain Acts. The subsection is amended, applicable after August 27, 1995, to delete references to the *Children's Special Allowances Act* and the *Income Tax Act* as a result of the transfer of the eligibility portion of the child tax benefit program to the Department of National Revenue.

Clause 174

General Procedure for Tax Appeals

Tax Court of Canada Act
17.2(1) to (3)

Section 17.2 of the *Tax Court of Canada Act* contains the proceedings applicable to appeals arising under the *Income Tax Act*

and Part IX of the *Excise Tax Act* (GST) that are governed by the general procedure. Subsections 17.2(1) and (2) of that Act are amended to provide that the originating document may be filed not only by depositing it in, or mailing it to, the Registry of the Court but also by any other means (including electronic means) that may be provided for in the rules of Court (e.g. by fax).

New subsection 17.2(2.1) provides that an originating document is deemed to be filed the day it is received by the Registry of the Court. This amendment removes uncertainty that occurs in determining when an appeal received by mail by the Registry was actually sent. New subsection 17.2(2.2) requires that, whenever the originating document is filed by a means other than mail or deposit, the appellant or his or her lawyer must send the original of the document and two copies thereof to the Registry of the Court. This will ensure that the Registry may adequately verify the accuracy of the copies of the originating document that have to be served on the Deputy Attorney General of Canada under subsection 17.2.

A consequential amendment is also made to subsection 17.2(3) so that the obligation for the Registry of the Court to transmit copies of the originating document is created at the time the Registry receives the original of the document as opposed to the time of filing. This is of particular importance where the document is filed by sending a copy of the originating document, as opposed to the original, by electronic means.

The amendments to subsections 17.2(1), (2) and (3) and new subsections 17.2(2.1) and (2.2) will come into force on a day or days to be fixed by an Order of the Governor in Council.

Clause 175

Informal Procedure for Tax Appeals

Tax Court of Canada Act
18.15

Section 18.15 of the *Tax Court of Canada Act* describes how appeals arising under the *Income Tax Act* and Part IX of the *Excise Tax Act* (GST) may be made to the Tax Court under the informal procedure.

It is to be noted that section 18.15 applies to GST appeals because section 18.302 makes section 18.15 applicable to appeals referred to in section 18.3001, that is, to GST appeals.

Filing fee

Tax Court of Canada Act
18.15(3)

Subsection 18.15(3) of the *Tax Court of Canada Act* is amended to add paragraph (*b*). This paragraph provides that a taxpayer must pay a filing fee of one hundred dollars when instituting an appeal governed by the informal procedure.

The amendment applies to appeals instituted after the fourth month that follows the month in which this Act is assented to.

Manner of Filing an Appeal

Tax Court of Canada Act
18.15(3.1) to (3.3)

Subsection 18.15(3.1) of the *Tax Court of Canada Act* is amended to provide that the written appeal may be filed not only by depositing it in, or mailing it to, the Registry of the Court but also by any other means (including electronic means) that may be provided for in the rules of Court (e.g. by fax).

New subsection 18.15(3.2) of that Act provides that a written appeal is deemed to be filed the day it is received by the Registry of the Court. This amendment removes uncertainty that occurs in determining when an appeal received by mail by the Registry was actually sent. New subsection 18.15(3.3) requires that, whenever the written appeal is filed by a means other than mail or deposit, the appellant or his or her counsel or agent must send the original of the document to the Registry of the Court.

New subsections 18.15(3.1) to (3.3) will come into force on a day or days to be fixed by an Order of the Governor in Council.

Waiver of filing fee

Tax Court of Canada Act
18.15(3.4) and (3.5)

Subsections 18.15(3.4) and (3.5) are being added to the *Tax Court of Canada Act* as a consequence of the introduction of the new requirement to pay a filing fee when an appeal under the *Income Tax Act* or part IX of the *Excise Tax Act* (GST) is instituted in the Tax Court and the appellant elects to have the informal procedure apply to the proceedings.

New subsection 18.15(3.4) allows the appellant to make an application to the Court not to have to pay the filing fee. The Court may grant that request if it believes that the levy of the fee would cause severe financial hardship to the applicant. The following situation may be an example of severe financial hardship: A is a single parent who has a dispute regarding the quantum of child tax benefit for which he or she is eligible. A's sole source of income is social assistance.

In deciding whether or not to grant such a request, new subsection 18.15(3.5) provides that the Court may solely consider the information contained in the written appeal. That subsection does not provide authority for the Court to access any other document or ask for representation from the appellant or the Attorney-General of Canada.

New subsections 18.15(3.4) and (3.5) apply to appeals instituted after the fourth month that follows the month in which this Act is assented to.

Clause 176

Reimbursement of Filing Fee

Tax Court of Canada Act
18.26

Section 18.26 of the *Tax Court of Canada Act* provides that where an income tax appeal governed by the informal procedure is allowed, the

Tax Court may, depending on the extent to which the appellant is successful, award costs to the appellant. The section is amended to provide that, where the appeal is allowed, the appellant that paid a filing fee in accordance with paragraph 18.15(3)(*b*) of that Act has the right to be reimbursed the fee by the Court even if he or she has been successful in part only.

This amendment is effective upon Royal Assent.

Clause 177

Variation of filing fee

Tax Court of Canada Act
18.27

Section 18.27 of the *Tax Court of Canada Act* provides the Governor in Council with the authority to make regulations to increase, amongst other things, the threshold amounts that an income tax appeal must meet to qualify, upon the making of an election to that effect by the appellant, for the application of the informal procedure. Subsection 18.27(1) is amended by adding paragraph (*d*). This paragraph provides the Governor in Council with the authority to make regulations to vary the amount of the filing fee that a taxpayer who elected that a GST or ITA appeal be governed by the informal procedure has to pay under paragraph 18.15(3)(*b*). The amount of $100 would, therefore, be capable of being increased or decreased by a regulations made by the Governor in Council.

This amendment is effective upon Royal Assent.

Clause 178

Appeals other than income tax or GST

Tax Court of Canada Act
18.29(1) and (3)

Subsection 18.29(1) of the *Tax Court of Canada Act* provides that the provisions governing the informal procedure for income tax appeals

also apply to appeals arising under Part I of the *Canada Pension Plan*, Parts III or VII of the *Unemployment Insurance Act* or, to some extent, the *Old Age Security Act*, the *War Veterans Allowance Act* or Part XI of the *Civilian War Pensions and Allowances Act*.

The first amendment to subsection 18.29(1) ensures that no filing fee will be levied where an appeal governed by the informal procedure arises under any of the above-mentioned legislation. This is achieved by carving out of the provisions referred to in that provision paragraph 18.15(3)(b) and subsections 18.15(3.4) and (3.5).

This amendment is effective upon Royal Assent.

The second amendment to subsection 18.29(1) makes applicable to the above-mentioned legislation new subsections 18.15(3.1) and (3.3) which deal with the manner of filing an appeal. Note that new subsection 18.15(3.2), which deems a written appeal to be filed on the day it is received by the Registry of the Court, is not made applicable to the above-mentioned legislation.

This amendment will come into force on a day or days to be fixed by an Order of the Governor in Council.

Finally, subsection 18.29(3) of that Act is amended to make subsection 18.15(3.2) applicable, in addition to the provisions already referred to in subsection 18.29(1), to applications for extension of time to make an objection or an appeal under the *Income Tax Act* or Part IX of the *Excise Tax Act* (GST). That amendment comes into force on a day or days to be fixed by an Order of the Governor in Council.

Clauses 179 and 180

GST Appeals

Tax Court of Canada Act
18.3001 and 18.3002

Sections 18.3001 to 18.302 of the *Tax Court of Canada Act* apply to appeals arising under Part IX of the *Excise Tax Act* (GST).
Section 18.3001 and subsection 18.3002(1) currently refer to

section 18.301. However, that section was renumbered as 18.302 by section 224 of Chapter 27 of the Statutes of Canada, 1993, effective upon Royal Assent, June 10, 1993. The amendments to section 18.3001 and subsection 18.3002(1) will substitute a reference to section 18.302 for the reference to section 18.301.

The amendments are deemed to have come into force on June 10, 1993, the day on which Chapter 27 of the Statutes of Canada, 1993 was assented to.

Clause 181

Reimbursement of Filing Fee

Tax Court of Canada Act
18.3009

Section 18.3009 of the *Tax Court of Canada Act* provides that where a GST appeal governed by the informal procedure is allowed, the Tax Court may, depending on the extent to which the appellant is successful, award costs to the appellant. The section is amended to provide that, where the appeal is allowed, the appellant that paid a filing fee in accordance with paragraph 18.15(3)(*b*) of that Act has the right to be reimbursed the fee by the Court even if he or she has been successful in part only.

The amendment is effective upon Royal Assent.

Clauses 182 to 184

Definitions

Tax Rebate Discounting Act
2(1)

The *Tax Rebate Discounting Act* establishes the procedures to be followed by tax discounters who acquire the right to a taxpayer's income tax refund, including the filing of prescribed forms.

The definition "Minister" in this Act is being amended to refer to the Minister of National Revenue as a consequence of the transfer of the administration of this Act from the Department of Industry to the Department of National Revenue.

The definition "prescribed" in this Act is being amended to remove the need to amend the regulations made under this Act in order to change the content of prescribed forms. The amendment will allow the prescribed forms to be revised on the authorization of the Minister of National Revenue, the same as the procedure followed for revising prescribed forms under the other Acts administered by that Minister.

Subparagraph 4(1)(b)(i) of this Act is being amended to delete the requirement that the discounting transaction be described in a prescribed manner. This change is consequential to the amendment of the definition "prescribed" described above. There is no need to refer to a prescribed manner, the description of the transaction will be part of the prescribed form.

These amendments apply on Royal Assent.

Clause 185

UI Withholdings

Unemployment Insurance Act
57(2)

Subsection 57(2) of the *Unemployment Insurance Act* provides for a deemed trust in respect of amounts deducted by an employer from the remuneration of an employee on account of unemployment insurance premiums. The amendment to this subsection is similar to the amendment to subsection 227(4) of the *Income Tax Act* described in subclause 148(1). This amendment comes into force on
June 15, 1994.

Clause 185.1

Electronic Records

Unemployment Insurance Act
58(3.1) and (3.2)

Subsection 58(1) of the *Unemployment Insurance Act* requires every employer paying remuneration to a person employed by the employer in insurable employment to keep records and books of account. New subsection (3.1) requires an employer who keeps records in an electronic format to retain them in that format for the retention period referred to in subsection 58(2). New subsection (3.2) enables the Minister to exempt an employer or a class of employers from the requirement to keep their records in electronic format under such terms and conditions as are acceptable to the Minister.

This amendment applies on Royal Assent.

Clause 186

Delegation

Unemployment Insurance Act
64(1.1)

New subsection 64(1.1) is added to the *Unemployment Insurance Act* to provide that the Minister of National Revenue may administratively delegate powers and duties of the Minister under Part III of the *Unemployment Insurance Act* to an officer or class of officers in the Department. This new subsection replaces the requirement that such delegation be done by a regulation under subsection 75(2) of that Act. This amendment will allow a more timely revision of the delegation of powers and duties of the Minister required by an amendment to the Act or a reorganization within the Department and is consequential to similar amendments to the *Income Tax Act*. This amendment applies on Royal Assent.

Clause 187

Appeal to Tax Court of Canada

Unemployment Insurance Act
70

Current subsection 70(1) of the *Unemployment Insurance Act* provides that an appeal to the Tax Court of Canada of a determination by, or of a decision on an appeal to, the Minister of National Revenue in respect of the liability for an employer or an employee to make a contribution under that Act, or as to the amount of such contribution, must be made in the prescribed manner. In effect, the rules governing those appeals are found in the *Tax Court of Canada Rules of Procedure respecting the Unemployment Insurance Act*. The amendment provides that the appeal shall be made in accordance with the *Tax Court of Canada Act*. Therefore, the rules governing those appeals will be contained in both the above-mentioned Rules of Procedure and the *Tax Court of Canada Act*.

This amendment will come into force on a day to be fixed by an Order of the Governor in Council to allow for that amendment to be in force simultaneously with the amendments made to the *Tax Court of Canada Act* in this Bill (see relevant notes in clauses 174 to 181) and new provisions that the Rules Committee will have to make to the *Tax Court of Canada Rules of Procedure respecting the Unemployment Insurance Act*.

Reasons For Decisions

Unemployment Insurance Act
70(2)

Subsection 70(2) of the *Unemployment Insurance Act* provides that when the Tax Court of Canada hears an appeal made by the Canada Employment and Immigration Commission or a person affected by a determination by, or a decision on an appeal to, the Minister under section 61 of that Act, the Tax Court must notify in writing the parties to the appeal of the reasons for its decision. In order to achieve greater procedural harmonization between income tax and unemployment insurance matters, this amendment removes the

obligation on the Tax Court to provide written reasons for its decision. Subsection 70(2) will therefore be similar, in that respect, to section 18.23 of the *Tax Court of Canada Act*, which governs appeals under the *Income Tax Act* that are subject to the informal procedure.

This amendment applies on Royal Assent.

Clause 188

Regulations for Delegation

Unemployment Insurance Act
75(2)

Subsection 75(2) of the *Unemployment Insurance Act* authorizes the making of regulations to delegate powers and duties of the Minister of National Revenue under Part III of that Act. This subsection is being repealed because of the addition of new subsection 64(1.1) to that Act, which allows for the delegation of powers and duties of the Minister on an administrative basis. This amendment applies on Royal Assent.

Clause 189

Appeal to Tax Court of Canada

Western Grains Transition Payments Act
4(4)

Subsection 4(4) deals with the income tax treatment of payments received under the *Western Grain Transition Payments Act*. Subsection 4(4) is amended to clarify that, where a payment is received by a taxpayer in respect of farmland that was held as capital property and that was disposed of by the taxpayer before receipt of the payment, the amount must be applied to reduce the adjusted cost base of the land immediately before the disposition. This ensures that taxpayers who dispose of their farmland before receiving the payment are treated as advantageously for tax purposes as those who had received the payment before disposition.

This amendment applies to payments made after June 22, 1995.

Clause 190

Small Business Deduction

S.C. 1988, c. 55
Subsections 102(1) and (5)

Income Tax Act
125(1)

Subsection 125(1) of the *Income Tax Act* establishes the special low rate of tax applicable to the income of a Canadian-controlled private corporation from an active business carried on in Canada. This preferential tax rate is provided by way of an annual tax credit, commonly referred to as the "small business deduction". This amendment repeals certain of the provisions enacting the 1988 amendments to subsection 125(1) of the Act. It is strictly consequential on the amendment to subsection 125(1) of the Act contained in this legislation, which corrects an error that occurred at the time of the 1988 amendments.

Clause 191

Consequential Amendments

ITA
95(6)

Subsection 95(6) of the Act is an anti-avoidance rule that applies for the purposes of sections 91 through 95 of the Act. It is designed to prevent the avoidance of tax through the use of rights to, or to acquire, shares of a corporation or through the acquisition or disposition of shares of a corporation.

The coming-into-force provision for the amendments to subsection 95(6) contained in section 46 of *An Act to amend the Income Tax Act, the Income Tax Application Rules and related Acts*, being chapter 21 of the Statutes of Canada, 1995 is amended to

clarify that those amendments apply only in respect of rights acquired and shares acquired or disposed of in taxation years of foreign affiliates that begin after 1994, except that, where there has been a change to the taxation year of a foreign affiliate in 1994 and after February 22, 1994, the amended subsection will apply in respect of rights acquired and shares acquired or disposed of in taxation years of such foreign affiliate that end after 1994. However, where a written request to change the taxation year had been made before February 22, 1994 to the income taxation authority of the country in which the affiliate was resident and subject to income taxation, or where the change in taxation year causes the first taxation year commencing after 1994 to commence earlier than if there had been no change in the affiliate's taxation year, the amended subsection will continue to apply in respect of rights acquired and shares acquired or disposed of in taxation years of the affiliate that begin after 1994.

Clause 192

Conditional Amendments

These conditional amendments are the same as the amendments described above in clauses 159, 185, 186, 187 and 188, and they address the situation that will prevail if Bill C-12 which also amends the *Unemployment Insurance Act* is assented to before this Act.

Subclause 192(1)

Electronic records

Employment Insurance Act
87(3.1) and (3.2)

Subsection 87(1) of the Act requires every employer paying remuneration to a person employed by the employer in insurable employment to keep records and books of account. Subsection (3.1) requires an employer who keeps records in an electronic format to retain them in that format for the retention period referred to in subsection 87(2). Subsection (3.2) enables the Minister to exempt an employer or a class of employers from the requirement to keep their records in an electronic format under such terms and conditions as are acceptable to the Minister.

These provisions apply to records created at any time in existence on or after the later of June 29, 1996 and the day on which this Act is assented to.

Clause 193

Conditional Amendments

These conditional amendments address the situation that will prevail if Bill C-36 which also amends the *Income Tax Act* is assented to before this Act.

Subclause 193(1)

ITA
37(13)

Subsection 37(13) of the Act deems certain work that would not otherwise be considered to be SR&ED to be SR&ED for the purposes of sections 37, 127 and 127.1 of the Act.

Subsection 37(13) is amended consequential on the introduction of the definition "scientific research and experimental development" in subsection 248(1) of the Act.

This amendment applies to taxation years thata begin after 1995.

ITA
96(3)

Subsection 96(3) of the Act provides rules that apply if a member of a partnership makes an election under certain provisions of the Act for a purpose that is relevant to the computation of the member's income from the partnership. In such case, the election will be valid only if it is made on behalf of all the members of the partnership and the member had authority to act for the partnership.

Subsection 96(3) is amended to treat an election filed by a member under section 15.2 and new subsections 249.1(4) and (6) in the same way as other elections referred to in subsection 96(3). This

amendment generally applies to fiscal periods that end after December 2, 1992.

ITA
127(9)

Subsection 127(9) of the Act provides definitions for terms that are used in the provisions relating to the investment tax credit (ITC).

"specified percentage"

The definition of "specified percentage" is amended consequential on the introduction of basis reductions in subsections 127(18) to (20) and the additions to the ITC in respect of repayments of those amounts in paragraphs (e.1) and (e.2) of the definition "investment tax credit".

This amendment applies to taxation years that begin after 1995.

ITA
150(1)(d)(ii)(A)

Subsection 150(1) of the Act requires taxpayers to file their income tax returns on or before certain dates. Clause 150(1)(d)(ii)(A) is amended to replace the reference to "tax shelter" with "tax shelter investment" consequential to the enactment of the definition "tax shelter investment" in new subsection 143.2(1). Generally, this amendment applies to the 1995 and subsequent taxation years.

ITA
249.1(5)

Subsection 249.1(5) of the Act provides that the "alternative fiscal-period method" in subsection 249.1(4) does not apply in the case of a business the expenditures of which are, or were, primarily tax shelters. Subsection 249.1(5) is amended, applicable to fiscal periods that begin after 1994, consequential on the enactment of the definition of "tax shelter investment" in new subsection 143.2(1).

Amendments to the *Income Tax Regulations* relating to Tax Shelters

1. (1) Subsections 231(4) and (5) of the *Income Tax Regulations* are repealed.

(2) Section 231 of the Regulations is amended by adding the following after subsection (6):

(6.1) For the purpose of paragraph (*b*) of the definition "tax shelter" in subsection 237.1(1) of the Act, "prescribed benefit" in relation to a property includes an amount that is a limited-recourse amount because of subsection 143.2(1), (7) or (13) of the Act, but does not include an amount of indebtedness that is a limited-recourse amount

(*a*) solely because it is not required to be repaid within 10 years from the time the indebtedness arose where the debtor would, if the property were acquired or made by the debtor immediately after that time, be

(i) a partnership

(A) at least 90% of the fair market value of the property of which is attributable to tangible capital property located in Canada of the partnership, and

(B) at least 90% of the value of all interests in which are held by limited partners (within the meaning assigned by subsection 96(2.4) of the Act) of the partnership,

except where it is reasonable to conclude that one of the main reasons for the acquisition of one or more properties by the partnership, or for the acquisition of one or more interests in the partnership by limited partners, is to avoid the application of this subsection, or

(ii) a member of a partnership having fewer than 6 members, except where

(A) the partnership is a member of another partnership,

(B) there is a limited partner (within the meaning assigned by subsection 96(2.4) of the Act) of the partnership,

(C) less than 90% of the fair market value of the property of the partnership is attributable to tangible capital property located in Canada of the partnership, or

(D) it is reasonable to conclude that one of the main reasons for the existence of one of two or more partnerships, one of which is the partnership, or the acquisition of one or more properties by the partnership, is to avoid the application of this section to the member's indebtedness, or

(*b*) of a partnership

(i) where

(A) the indebtedness is secured by and used to acquire tangible capital property located in Canada (other than rental property, within the meaning assigned by subsection 1100(14), leasing property, within the meaning assigned by subsection 1100(17), or specified energy property, within the meaning assigned by subsection 1100(25)) of the partnership, and

(B) the person to whom the indebtedness is repayable is a member of the Canadian Payments Association, and

(ii) throughout the period during which any amount is outstanding in respect of the indebtedness,

(A) at least 90% of the fair market value of the property of which is attributable to tangible capital property located in Canada of the partnership,

(B) at least 90% of the value of all interests in which are held by limited partners (within the meaning assigned by subsection 96(2.4) of the Act) that are corporations, and

(C) the principal business of each such limited partner is related to the principal business of the partnership,

except where it is reasonable to conclude that one of the main reasons for the acquisition of one or more properties by the partnership, or for the acquisition of one or more interests in the partnership by limited partners, is to avoid the application of this subsection.

2. (1) Subsection 1(1) applies after 1995.

(2) Subsection 1(2) applies after November 1994.

Draft Amendment to *Income Tax Regulations* and Explanatory Note

Earned Depletion Allowances

Draft Amendment:

1. (1) Paragraph 1202(5)(*c*) of the *Income Tax Regulations* is replaced by the following:

(*c*) in respect of a property acquired at any time by purchase, amalgamation, merger, winding-up or otherwise, from a person who is exempt from tax under Part I of the Act on that person's taxable income.

(2) Subsection (1) applies to acquisitions that take place after April 26, 1995, other than an acquisition that takes place before 1996 and that was required by an agreement in writing entered into before April 26, 1995.

Explanatory Note:

Income Tax Regulations
1202(5)(c)

Part XII of the *Income Tax Regulations* sets out a number of rules with respect to resource and processing allowances. These rules include provision for the inheritance by a corporation (the "successor") of another taxpayer's earned depletion allowances, mining exploration base, frontier exploration base and supplementary depletion allowances. Subsection 1202(5) of the Regulations provides that this successoring is not available in certain circumstances, including (in paragraph 1202(5)(c)) the acquisition of property from a person that is exempt from tax under Part I of the Act. The paragraph includes an exception, however: where the exempt person from whom the property is acquired is a corporation described in paragraph 149(1)(d) – broadly, a Crown or municipal corporation – that is also a principal-business corporation, the successor rules will

apply. Paragraph 1202(5)(c) is amended to remove this exception. The amendment applies to any acquisition that takes place after April 26, 1995, other than an acquisition taking place before 1996 that was required by an agreement in writing entered into before April 26, 1995.