Explanatory Notes Relating to Income Tax

Published by
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Minister of Finance

December 1997

Department of Finance Canada
Ministère des Finances Canada

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Price: $58

Available from the Finance Canada Distribution Centre
300 Laurier Avenue West, Ottawa K1A 0G5
Tel: (613) 943-8665
Fax: (613) 996-0518

Cette publication est également disponible en français.

Cat No.: F2-97/2-1997E

ISBN-0-660-17274-7

PREFACE

These explanatory notes relate to proposed amendments to the *Income Tax Act* and other statutes. These notes describe these proposed 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 proposed amendments to the *Income Tax Act* and other statutes. These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

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PART I

DIVISION A

EXPLANATORY NOTES TO DRAFT AMENDMENTS

1997 BUDGET INCOME TAX PROPOSALS

Clause 2

Income from Business or Property

ITA
12

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

ITA
12(1)(*z*.1) and (*z*.2)

Paragraph 12(1)(*z*.1) of the Act provides that any amount received by a taxpayer in the taxpayer's capacity as a beneficiary of a mining reclamation trust is to be included in computing the taxpayer's income for tax purposes. Paragraph 12(1)(*z*.2) provides that consideration received by a taxpayer for the sale of the taxpayer's interest as a beneficiary of a mining reclamation trust is also generally included in computing the taxpayer's income.

Paragraphs 12(1)(*z*.1) and (*z*.2) are amended so that each reference to a "mining reclamation trust" is replaced by a broader reference to a "qualifying environmental trust". These amendments are in consequence of the extension of the rules for mining reclamation trusts reflected by the new definition "qualifying environmental trust" in subsection 248(1). For more details, see the commentary on that definition.

These amendments apply to taxation years that end after February 18, 1997.

Clause 3

Prohibited Deductions

ITA
18

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

ITA
18(11)

Paragraphs 20(1)(*c*), (*d*), (*e*), (*e*.1) and (*f*) of the Act permit deductions for interest and certain other financing expenses relating to borrowed money used by a taxpayer for the purpose of earning money from a business or property. These provisions are, however, subject to subsection 18(11) which prohibits the deduction of such expenses in respect of indebtedness incurred for the purposes of making a contribution to an RRSP or certain other deferred income plans.

Subsection 18(11) is amended to ensure that interest and similar expenses are not deductible in respect of borrowed money used to contribute to a registered education savings plan.

This amendment applies to 1998 and subsequent taxation years.

Clause 4

Income from a Business or Property – Deductions

ITA
20

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

ITA
20(1)(*ss*) and (*tt*)

Paragraph 20(1)(*ss*) of the Act provides that contributions made by a taxpayer to a mining reclamation trust of which the taxpayer is a beneficiary are deductible in computing the taxpayer's income for the taxation year in which the contributions were made.

Paragraph 20(1)(*tt*) of the Act generally provides that any consideration paid by a taxpayer for the acquisition of an interest in a mining reclamation trust is deductible in computing the taxpayer's income for the year of acquisition.

These provisions are amended so that the references to "mining reclamation trust" are replaced by broader references to "qualifying environmental trust". These amendments are in consequence of the extension of the rules for mining reclamation trusts reflected by the new definition "qualifying environmental trust" in subsection 248(1). For more details, see the commentary on that definition.

These amendments apply to taxation years that end after February 18, 1997. However, a special transitional rule applies in the case of qualifying environmental trusts (other than mining reclamation trusts) to which contributions were first made after 1995 but before February 19, 1997. In this case, contributions made before February 19, 1997 will be considered to be made on February 19, 1997 so that they will qualify for deduction under paragraph 20(1)(*ss*).

Clause 5

Scientific Research and Experimental Development

ITA
37

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

ITA
37(12)

Subsection 37(11) generally provides that, in order to deduct an amount as a scientific research and experimental development (SR&ED) expenditure under subsection 37(1), the taxpayer must file a form with Revenue Canada within one year of the taxpayer's filing-due date for the year in which the expenditure was incurred, identifying the expenditure and supporting its characterization as SR&ED.

Subsection 37(12) of the existing Act provides that the filing requirement in subsection 37(11) does not apply where an expenditure is reclassified by the Minister of National Revenue as an expenditure on or in respect of scientific research and experimental development.

Amended subsection 37(12) deems an expenditure in respect of which the taxpayer has not met the filing requirement in subsection 37(11) not to be an expenditure on or in respect of scientific research and experimental development. This will cause the expenditure to be classified in accordance with the scheme of the Act, but without reference to the provisions relating to scientific research and experimental development. For example, an expenditure on equipment, which would have been an SR&ED capital expenditure if the prescribed form had been filed on time, would generally be treated as depreciable property, while an expenditure which would have been an SR&ED current expenditure would generally be deductible as a current expense under section 9.

This amendment applies to the 1997 and subsequent taxation years.

Clause 6

Taxable Capital Gains

ITA
38(*a*) and (*a*.1)

The portion of a taxpayer's capital gain that is required to be included in computing income is his or her "taxable capital gain".

New paragraph 38 (*a*.1) provides that if a capital gain results from the making of a gift to a qualified donee of a security listed on a stock exchange, a share or unit of a mutual fund, an interest in a segregated fund or a prescribed debt obligation, only 3/8 of the gain will be a taxable capital gain and hence included in income. For this purpose a qualified donee means any person, other than a private charitable foundation, to whom gifts may be made that qualify for the charitable donations deduction or tax credit. This preferential income inclusion rate will also apply to the deemed capital gain arising on the death of an individual to the extent that the property is the subject of a gift, described above, in the individual's will. It is intended that "prescribed debt obligation" be defined by regulation to include certain debt obligations that have a readily determinable market value such as government bonds. This amendment applies to gifts made after February 18, 1997 and before 2002.

Clause 7

Capital Gain and Capital Loss

ITA
39

Section 39 of the Act sets out the meaning of capital gain, capital loss and business investment loss and provides a number of special rules relating to capital gains.

Subclause 7(1)

ITA
39(1)(*a*)(v)

A taxpayer's capital gain for a taxation year from the disposition of property is determined under paragraph 39(1)(*a*) of the Act. Because of subparagraph 39(1)(*a*)(v), a disposition of an interest of a beneficiary under a mining reclamation trust does not give rise to any capital gain.

Subparagraph 39(1)(*a*)(v) is amended so that the reference to a "mining reclamation trust" is replaced by a broader reference to a "qualifying environmental trust". This amendment is in consequence of the extension of the rules for mining reclamation trusts reflected

by the new definition "qualifying environmental trust" in subsection 248(1). For more details, see the commentary on that definition.

This amendment applies to taxation years that end after February 18, 1997.

Subclause 7(2)

Mutual Funds

ITA
39(5)

Subsection 39(5) of the Act provides a list of taxpayers who are not entitled to the election under subsection 39(4) to treat any gain or loss arising on disposition of Canadian securities as a capital gain or loss.

Subsection 39(5) is amended to exclude from the list a taxpayer that is a mutual fund corporation or a mutual fund trust. This amendment clarifies that prescribed labour-sponsored venture capital corporations (which under subsection 131(8) are generally treated as mutual fund corporations) and other mutual funds can elect to treat each gain or loss arising on a disposition of a Canadian security as a capital gain or capital loss.

This amendment generally applies to the 1991 and subsequent taxation years. In addition, under a transitional rule, a mutual fund corporation or mutual fund trust has until its filing-due date for its first taxation year that includes the date of Royal Assent to file the election required under subsection 39(4) in prescribed form. In these circumstances, the election applies from the taxation year specified in the election provided that the specified year is no earlier than its 1991 taxation year and no later than its taxation year that includes the date of Royal Assent.

It should be noted that it is intended that a parallel change will be made to paragraph (*c*) of the definition "eligible corporation" in subsection 5100(1) of the *Income Tax Regulations* to exclude mutual fund corporations from the application of that paragraph for the 1991 and subsequent taxation years.

Clause 8

Capital Gains

ITA
40(1.01)

When a taxpayer makes a charitable gift of a non-qualifying security new subsections 110.1(6) and 118.1(13) of the Act provide that the gift will be ignored for the purposes of the charitable donations deduction and tax credit, respectively. However, if the donee disposes of the security within five years the donor will be treated as having made a gift at that later time. New subsection 40(1.01) of the Act is introduced in order to permit the taxpayer to claim a reserve in respect of any gain realized from the making of the original gift so that the resulting inclusion in income can be shifted to a later year, including, in particular, the year in which the donor ultimately receives recognition under section 110.1 or 118.1 for the donation. The reserve cannot be claimed once the taxpayer receives tax recognition for the gift nor if the taxpayer becomes non-resident or tax-exempt. If the security is not disposed of within the five year period by the donee, the donor will not be required to bring the reserve back into income in the year following expiration of the period. This amendment applies to the 1997 and subsequent taxation years.

Clause 9

Amounts Included in Income

ITA
56

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

Subclauses 9(1) and (2)

CPP/QPP Benefits

ITA
56(1)(*a*)(i) and (*a*.1)

Subparagraph 56(1)(*a*)(i) of the Act includes in the income of a taxpayer for a taxation year certain pension benefits received in the year, including death benefits under the Canada Pension Plan (CPP) and Quebec Pension Plan (QPP).

Subparagraph 56(1)(*a*)(i) is amended so that any CPP/QPP death benefit is ignored under that subparagraph. Instead, any CPP/QPP death benefit in respect of the death of an individual will be included under new paragraph 56(1)(*a*.1) in the income of the estate that arose on or as a consequence of the death of the individual.

These amendments apply to 1997 and subsequent taxation years. However, any CPP/QPP death benefit in respect of the death of an individual received by the individual's estate on or before July 31, 1997 is not covered by these amendments.

Subclause 9(3)

CPP/QPP Benefits for Previous Years

ITA
56(8)

Subsection 56(8) of the Act allows an individual to exclude from income in the year of receipt CPP/QPP disability benefits that relate to one or more prior years (except where the prior year benefits are less than $300) and to pay tax on those benefits as if they had been received in the prior years to which they relate. The payment of tax on this basis is provided for in section 120.3 of the Act. This amendment broadens the application of subsection 56(8) to all CPP/QPP benefits of at least $300 that relate to prior years.

This amendment applies to benefits received after 1994.

Clause 10

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 in excess of two-thirds of earned income for that year.

This amendment to the English version of the definition "earned income" is consequential on the amendment to paragraph 56(8)(*a*). It ensures that, while all types of benefits received under the Canada and Quebec Pension Plans may be eligible for the special tax treatment provided under that paragraph, only disability pensions paid under those plans may be included in computing an individual's earned income for the purposes of the child care expense deduction.

This amendment applies to amounts received after 1994.

Clause 11

Attendant Care Expenses

ITA
64

Section 64 of the Act permits the deduction, in computing the income of an individual who has a severe and prolonged mental or physical impairment, of expenses paid to an attendant (other than the individual's spouse) who is at least 18 years of age that are incurred

to enable the individual to work. Such an individual is entitled under the existing Act to deduct the least of the three following amounts:

- the actual amount of expenses for attendant care provided in Canada,
- 2/3 of the individual's earned income for the year, and
- $5,000.

These amendments remove the $5,000 limitation in section 64 and apply for 1997 and subsequent taxation years.

Clause 12

Reserves for Year of Death

ITA
72(1)(*c*)

Paragraph 72(1)(*c*) of the Act denies the deductibility of the capital gains reserves in subparagraphs 40(1)(*a*)(iii) and 44(1)(*e*)(iii) in the year in which a taxpayer dies. This amendment adds a reference to new paragraph 40(1.01)(*c*) of the Act so that a taxpayer will not be able to claim this special reserve, which is available in respect of a gain arising from the making of a charitable donation of a non-qualifying security, in the year of death. This amendment applies to the 1997 and subsequent taxation years.

Clause 13

Attribution Rule

ITA
75

Section 75 of the Act provides that where a person transfers property to a trust under certain conditions, any income from the property is attributed to the transferor.

ITA
75(3)(*c*.1)

Subsection 75(3) of the Act exempts income from property held by mining reclamation trusts and certain other trusts from the attribution rule in subsection 75(2).

Paragraph 75(3)(*c*.1) is amended so that the reference to a "mining reclamation trust" is replaced by a broader reference to a "qualifying environmental trust". This amendment is in consequence of the extension of the rules for mining reclamation trusts reflected by the new definition "qualifying environmental trust" in subsection 248(1). For more details, see the commentary on that definition.

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

Clause 14

Amounts not Included in Income

ITA
81(1)(*o*) and (*p*)

Paragraph 81(1)(*o*) of the Act provides that a "refund of payments" (as defined in subsection 146.1(1)) under an education savings plan is not to be included in computing a taxpayer's income.
Paragraph 81(1)(*p*) provides that an "educational assistance payment" received by a beneficiary from a non-registered or revoked education savings plan is likewise not included in computing a taxpayer's income.

Paragraph 81(1)(*o*) is repealed by this amendment because it is unnecessary. There is nothing in the Act that would otherwise include a "refund of payments" in computing a taxpayer's income.

Paragraph 81(1)(*p*) is also repealed. Because subsection 146.1(14) is being repealed, no amount is included in the income of a subscriber upon the revocation of a registered education savings plan. Consequently, it is no longer appropriate to exclude educational assistance payments from revoked registered retirement saving plans

from income. In addition, it is not appropriate to provide an income exclusion for an education savings plan that has never been registered.

These amendments apply to 1998 and subsequent taxation years.

Clause 15

Amalgamations

ITA
87(2)(*m*.1)

New subsection 40(1.01) of the Act permits a taxpayer to claim a reserve in respect of a capital gain arising from the making of a charitable donation of a non-qualifying security. Where two or more companies amalgamate new paragraph 87(2)(*m*.1) of the Act treats the amalgamated company as a continuation of each of its predecessors so that if a predecessor claimed a reserve under paragraph 40(1.01)(*c*) in its last taxation year the same amount will be included under paragraph 40(1.01)(*b*) in the amalgamated company's income for its first taxation year. By virtue of paragraph 88(1)(*e*.2) of the Act this rule applies equally upon the winding-up of a wholly-owned subsidiary into its parent corporation. This amendment applies to the 1997 and subsequent taxation years.

Clause 16

Windings-Up

ITA
88(1)(*e*.61)

In certain circumstances new subsections 110.1(6) and 118.1(13) of the Act will apply to treat a wholly-owned subsidiary corporation that has been wound up as having made a charitable donation after the corporation has ceased to exist. In such cases new paragraph 88(1)(*e*.61) will apply to treat the gift as having been made by the subsidiary's parent corporation so that it may claim the

resulting deduction under section 110.1 in computing its taxable income. This amendment applies after July 31, 1997.

Clause 17

Definitions

ITA
89(1)

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

Subclauses 17(1) and (2)

"capital dividend account"

A private corporation's capital dividend account includes, among other items, the non-taxable portion of the corporation's net taxable capital gains. In order to integrate the taxation of a corporation and its shareholders, dividends are received tax-free by shareholders when they are paid out of this account. Subclauses 17(1) and (2) propose amendments to exclude capital gains and losses resulting from the making of gifts by the corporation from the computation of its capital dividend account.

These amendments apply to gifts made after November 1997.

Subclause 17(3)

"public corporation"

Subsection 89(1) of the Act contains the definition "public corporation" which, by virtue of subsection 248(1), is relevant for all purposes of the Act.

The definition is amended to provide that a prescribed labour-sponsored venture capital corporation is not a public corporation for the purposes of the Act unless a class of its shares becomes listed on a prescribed stock exchange in Canada. For this

purpose, it is intended that section 6701 of the Regulations will be amended to add a cross reference to this definition.

This amendment applies to the 1995 and subsequent taxation years.

Clause 18

Beneficiaries of Qualifying Environmental Trusts

ITA
107.3

Section 107.3 of the Act sets out a number of rules dealing with the taxation of the beneficiaries of "mining reclamation trusts", as defined in subsection 248(1).

Section 107.3 is amended so that each reference to a "mining reclamation trust" is replaced by a broader reference to a "qualifying environmental trust". Similarly, a reference to a "mine" is replaced by a broader reference to a "site". These amendments are in consequence of the extension of the rules for mining reclamation trusts reflected by the new definition "qualifying environmental trust" in subsection 248(1). For more details, see the commentary on that definition.

Subsection 107.3(3) is also amended so that, in the event that a trust ceases to be a qualifying environmental trust at any time, the taxation year of the trust is deemed to have ended immediately before that time (rather than at that time, as is provided under the existing provision). Consequently, tax under Part XII.4 will apply to the trust for the taxation year that is deemed to have ended because of the change in status.

These amendments apply to taxation years that end after February 18, 1997.

Clause 19

Trusts – Definitions

ITA
108

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

ITA
108(1)

"preferred beneficiary"

Subsection 108(1) of the Act defines the expression "preferred beneficiary", which is relevant for the purpose of the preferred beneficiary election in subsection 104(14). A preferred beneficiary for a trust's taxation year is essentially an individual who

- is resident in Canada,
- is a beneficiary under the trust at the end of the trust's taxation year who is entitled to a disability tax credit under subsection 118.3(1) of the Act for the individual's taxation year in which the trust's taxation year ends, and
- is the trust settlor, the settlor's spouse or former spouse, a child, grandchild or great-grandchild of the settlor or a spouse of such a person.

The definition "preferred beneficiary" is amended so that the requirement that the beneficiary under a trust be entitled to a tax credit under subsection 118.3(1) is satisfied for a trust taxation year where the beneficiary is entitled to the tax credit for the beneficiary's taxation year that ends in the trust year. This amendment affects only testamentary trusts with non-calendar year ends. It ensures that trustees of a testamentary trust will know, with greater certainty, the status of a beneficiary by the time a preferred beneficiary election is made in respect of the beneficiary.

This definition is also amended to provide that an adult is not excluded as a "preferred beneficiary" for a trust taxation year because the adult is not entitled to the tax credit under subsection 118.3(1), where the adult is a dependant (within the meaning assigned by subsection 118(6)) of another individual for the adult's taxation year that ends in the trust year because of mental or physical infirmity and an income test is satisfied. The income test is satisfied where the adult's income (computed without reference to any amount designated under a preferred beneficiary election and allocated to the adult) for the adult's year that ends in the trust year does not exceed $6,456. The $6,456 limit is the same as the income limit used for the purposes of the dependant tax credit under subsection 118(1) of the Act. Amended subsection 117.1(1) of the Act provides for the indexing of this new limit.

These amendments apply to trust taxation years that end after 1996.

Clause 20

Charitable Donations Deduction

ITA
110.1

Section 110.1 of the Act provides for the deductibility in computing taxable income of charitable donations and certain other gifts made by corporations.

Subclause 20(1)

ITA
110.1(1) and (1.1)

Subsection 110.1(1) of the Act provides for the deduction of a corporation's charitable donations, gifts to the Crown and certain gifts of cultural property and ecologically sensitive land. Donors may carry forward unused deductions for up to five years.

Under the existing Act the deduction for charitable donations is limited to 50 per cent of the corporation's net income for the year of the donations, plus 50 per cent of any taxable capital gains resulting

from the making of the donations. Crown gifts and gifts of cultural property and ecologically sensitive land are not subject to this limitation under the existing Act. The present amendment provides that both charitable gifts and Crown gifts are to be subject to a new deduction limit, namely, 75 per cent of the corporation's net income, 25 per cent of any taxable capital gain resulting from the gifts plus 25 per cent of any recapture of depreciation included in income as a result of the making of the gifts. This new limitation applies to gifts deducted in taxation years that begin after 1996, except that there will be no limitation on Crown gifts made before February 19, 1997 nor on Crown gifts made pursuant to an agreement in writing made before that date.

New subsection 110.1(1.1) of the Act contains two rules governing the deductibility of charitable donations and other gifts under subsection 110.1(1). The first rule is that once the amount of a gift has been deducted in a taxation year it may not be carried forward to be deducted again in a future year. This rule is now contained in the definition of each of the four types of gift in subsection 110.1(1). The second rule, in paragraph 110.1(1.1)(*b*), is that gifts will be considered to be deducted in the order that they were made. This "first-in, first-out" assumption reflects Revenue Canada's interpretation of section 110.1 of the existing Act and is the assumption most favourable to taxpayers. New subsection 110.1(1.1) applies in computing taxable income for taxation years that begin after 1996.

Subclause 20(2)

ITA
110.1(5) to (7)

Certain gifts of ecologically sensitive land are deductible under paragraph 110.1(1)(*d*) of the Act in computing a corporate donor's taxable income. For this purpose "land" includes a covenant, easement or servitude to which land is subject. As it is generally difficult to establish the fair market value of these rights, new subsection 110.1(5) of the Act is introduced to provide that the fair market value of a gift of a covenant, easement or servitude will not be considered to be less than the decrease in value of the subject land that resulted from the making of the gift. This amendment applies to gifts made after February 27, 1995.

New subsections 118.1(13), (14) and (16) to (20) of the Act apply to deny or defer an individual's charitable donations tax credit in certain circumstances. New subsection 110.1(6) provides that those rules are to apply equally in determining a corporation's charitable donations deduction. Where because of new subsection 118.1(13) a corporation's deduction for a charitable donation would be deferred until after the corporation has ceased to exist, new subsection 110.1(7) of the Act treats the corporation as having made the donation in its last taxation year. An exception is provided for corporations which have ceased to exist as a result of an amalgamation under subsection 87(1) or a winding-up under subsection 88(1). In that case the new corporation or the parent corporation will be treated under paragraph 87(2)(*v*) or 88(1)(*e*.61), respectively, as having made the donation at the time provided for in new subsection 118.1(13). These amendments apply after July 31, 1997.

Clause 21

Annual Adjustment of Deductions and Other Amounts

ITA
117.1(1)

Subsection 117.1(1) of the Act provides for the indexing of various amounts, including the amounts on which the personal tax credits are based. The indexing is based on annual increases in the Consumer Price Index in excess of 3 per cent.

These amendments renumber existing paragraphs 117.1(1)(*a*) and (*a*.1) of the Act as paragraphs 117.1(1)(*b*.1) and (*b*.2), respectively. This change, effective for 1997 and subsequent taxation years, allows for the insertion of new paragraph 117.1(1)(*a*).

New paragraph 117.1(1)(*a*) and further amendments to subsection 117.1(1) provide for the indexing after 1996 of the $6,456 income limit for preferred beneficiaries, described in the commentary to the amended definition "preferred beneficiary" in subsection 108(1) of the Act. These amendments apply to 1997 and subsequent taxation years.

Paragraph 117.1(1)(*b*.2) is amended as a consequence of new section 122.51 of the Act dealing with the refundable medical expense supplement for low-income earners. The $500 maximum amount of the supplement, as well as the threshold amounts of $2,500 and $16,069, will also be indexed. This amendment applies to 1998 and subsequent taxation years.

Clause 22

Charitable Donations Tax Credit

ITA
118.1

Section 118.1 of the Act provides the tax credit that may be claimed by individuals who make charitable donations, gifts to the Crown and certain gifts of cultural property and ecologically sensitive land. Donors may carry forward unused claims for up to five years.

Subclauses 22(1) to (4)

ITA
118.1(1)

Subsection 118.1(1) of the Act provides definitions of various terms for purposes of the charitable donations tax credit, including "total gifts" which is the amount on which the tax credit is determined under subsection 118.1(3) of the Act.

Under the existing Act the amount of charitable donations that may be included in an individual's total gifts for a taxation year is limited to 50 per cent of the individual's net income for the year plus 50 per cent of any taxable capital gains resulting from the making of the donations. Crown gifts and gifts of cultural property and ecologically sensitive land are not subject to this limitation under the existing Act. The amendments to subsection 118.1(1) provide that both an individual's charitable donations and gifts to the Crown are to be subject to a new limit on inclusion in the individual's total gifts, namely, 75 per cent of the individual's net income, 25 per cent of any taxable capital gains resulting from the gifts (to the extent that they were not excluded from the individual's taxable income by the

lifetime capital gains exemption in section 110.6 of the Act) plus 25 per cent of any recapture of depreciation included in income as a result of the making of the gifts. This new limitation applies to gifts deducted in taxation years that begin after 1996, except that there will be no limitation on Crown gifts made before February 19, 1997 nor on Crown gifts made pursuant to agreements in writing made before that date.

Subclause 22(5)

ITA
118.1(2.1)

New subsection 118.1(2.1) of the Act provides that gifts will be considered to have been claimed in determining an individual's charitable donations tax credits in the order in which they were made. This "first-in, first-out" assumption reflects Revenue Canada's interpretation of section 118.1 of the existing Act and is the assumption most favourable to taxpayers. New subsection 118.1(2.1) applies to taxation years that begin after 1996.

Subclause 22(6)

ITA
118.1(4) and (5)

Subsection 118.1(4) of the Act treats a gift made in the year of an individual's death as having been made in the preceding year to the extent that it was not deducted in the year of death. This provision is modified in two ways. First, this amendment clarifies that subsection 118.1(4) is subject to subsection 118.1(13) of the Act so that where an individual has made a gift of a non-qualifying security in the year in which the individual died the gift will not be considered to have been made in the preceding year because of the application of subsection 118.1(4), but rather paragraph 118.1(13)(*a*) applies to treat the gift as not having been made. Secondly, the amendment ensures that where a gift is deemed to have been made by an individual in the year of death under subsection 118.1(5) (gift made by will) or subsection 118.1(13) or (15) (gift deemed to have been made when donee disposes of a non-qualifying security), subsection 118.1(4) will apply to treat the gift as having been made

in the year preceding the year of the death. This amendment applies to gifts made after July 31, 1997.

Subsection 118.1(5) of the Act treats a gift made by an individual's will as having been made immediately before the individual's death. This amendment clarifies that, where a gift of a non-qualifying security is made by a will, subsection 118.1(13) of the Act is to prevail to treat the gift as not having been made. This amendment applies to gifts made after July 31, 1997.

Subclause 22(7)

ITA
118.1(12) to (20)

Certain gifts of ecologically sensitive land are included in an individual's "total ecological gifts" (as defined in subsection 118.1(1) of the Act) for the purpose of determining the individual's charitable donations tax credit. For this purpose "land" includes a covenant, easement or servitude to which land is subject. As it is generally difficult to establish the fair market value of these rights, new subsection 118.1(12) of the Act is introduced to provide that the fair market value of a gift of a covenant, easement or servitude will not be considered to be less than the decrease in value of the subject land that resulted from the making of the gift. This amendment applies to gifts made after February 27, 1995.

New subsection 118.1(13) of the Act provides that if an individual makes a gift of a non-qualifying security, that gift will be ignored for the purpose of the charitable donations tax credit. However, if the donee disposes of the security within five years or the security ceases to be a non-qualifying security of the individual within five years, the individual will be treated as having made a gift at that later time. The fair market value of the later gift will be considered to be the lesser of two amounts. The first amount is the consideration received by the donee for the disposition (except to the extent that the consideration is another non-qualifying security of the individual) or in the case of the security ceasing to be a non-qualifying security, its fair market value at that later time. The second amount is the fair market value of the original gift as modified by subsection 118.1(6). This subsection does not apply to excepted gifts. An excepted gift is defined by subsection 118.1(19) of the Act to be a gift of a share to

an arm's length donee that is not a private foundation, provided that if the donee is a charitable organization or a public foundation the donor deals at arm's length with the foundation's directors and officers.

New subsection 118.1(14) of the Act provides that if a donee receives a new share in the course of certain corporate reorganizations in exchange for a share that was a non-qualifying security of an individual, the new share will be considered to be the same share as the original share. This ensures that the individual will be deemed under subsection 118.1(13) to have made a charitable gift if the new share is subsequently disposed of by the donee within five years from the donation of the original share.

For the purpose of new subsections 118.1(13), (14) and (15), new subsection 118.1(18) of the Act defines a non-qualifying security of an individual to be an obligation of the individual or a non-arm's length person, a share issued by a corporation with which the individual does not deal at arm's length or any other security issued by the individual or a non-arm's length person. Specifically excepted from this definition are obligations, shares and other securities listed on prescribed stock exchanges and deposits with financial institutions. For this purpose "financial institution" is defined in new subsection 118.1(20) of the Act as being a member of the Canadian Payments Association or a credit union that is a shareholder or member of a central for the purposes of the Canadian Payments Association Act.

Where an individual makes a gift of a non-qualifying security and dies before the donee disposes of the gift within the prescribed five-year period, new subsection 118.1(15) of the Act will apply to treat the subsequently resulting gift as having been made by the individual in the year of death, rather than at the time of the disposition by the donee.

New subsection 118.1(16) of the Act applies in two cases. The first case occurs where an individual makes a gift, the donee holds a non-qualifying security of the individual within five years thereafter and the donee acquired the security no earlier than five years before the gift was made. The second case occurs where an individual makes a gift to a non-arm's length donee, the individual or a non-arm's length person uses property of the donee within five years

thereafter, the use of the property was pursuant to an agreement made no earlier than five years before the making of the gift and the use of the property was not in the course of the donee's charitable activities. In either of these cases the fair market value of the gift will be reduced for the purpose of the individual's charitable donations tax credit. In the case of the acquisition of a non-qualifying security the gift's value will be reduced by the fair market value of the consideration given by the donee to acquire the security. In the case of the use of property, the gift will be reduced by the fair market value of the property. New subsections 118.1(13) to (16) generally apply after July 31, 1997.

New subsection 118.1(17) of the Act applies an ordering rule for the purpose of subsection 118.1(16) so that the acquisition of a non-qualifying security of a donor by a donee or the use of a donee's property by a donor will reduce the donor's charitable donations tax credits on a "first-in, first out" basis. For example, if in each of years 1 to 3 a donor makes a gift of $100 and in year 4 the donee acquires a non-qualifying security of the donor for $130, subsections 118.1(16) and (17) apply to eliminate the gift in year 1 and to reduce the gift in year 2 to $70. The gift in year 3 is not affected. This amendment applies after July 31, 1997.

Clause 23

Medical Expense Tax Credit

ITA
118.2

Section 118.2 of the Act provides the medical expense tax credit.

Subclause 23(1)

ITA
118.2(2)(*b*.1)

Paragraph 118.2(2)(*b*.1) of the Act allows amounts paid as remuneration for part-time attendant care in Canada for an individual who has a severe and prolonged mental or physical impairment to qualify, up to a maximum of $5,000 ($10,000 if the individual has

died in the year), as medical expenses, provided the amounts are paid to an attendant (other than the individual's spouse) who is at least 18 years of age and no other deduction is claimed in respect of those amounts. This amendment increases the $5,000 and $10,000 maximums to $10,000 and $20,000, respectively.

This amendment applies to 1997 and subsequent taxation years.

Subclause 23(2)

ITA
118.2(2)(*l*.4) to (*l*.7)

Subsection 118.2(2) of the Act lists the expenses that are considered qualifying medical expenses.

This amendment adds to the list of qualifying medical expenses the following four items:

- fees for sign language interpretation services provided to an individual who has a speech or hearing impairment, if the fees are paid to a person engaged in the business of providing such services;

- reasonable moving expenses (up to a maximum of $2,000) of an individual who lacks normal physical development or has a severe and prolonged mobility impairment to move to a dwelling that is more accessible by the individual or in which the individual is more mobile or functional;

- reasonable costs of alterations to the driveway of the principal place of residence of an individual who has a severe and prolonged mobility impairment to facilitate the individual's access to a bus; and

- an amount (not in excess of $5,000) equal to 20 per cent of the cost of a van that, at the time of its acquisition or within six months after that time, has been adapted for the transportation of an individual who requires the use of a wheelchair.

This amendment applies to 1997 and subsequent taxation years.

Subclause 23(3)

ITA
118.2(2)(*m*)

Under paragraph 118.2(2)(*m*) of the Act the cost of a device or of equipment may qualify as a medical expense if it is of a kind the Governor in Council has prescribed by regulation, having regard, where applicable, to the purpose of its acquisition or use. The amendment broadens the scope of the regulations by allowing the Governor in Council to stipulate a dollar limit for claims in respect of a particular device or equipment. The amendment is consequential on the inclusion, as a qualifying medical expense, of the cost (up to a maximum of $1,000) of an air conditioner to be used by an individual to cope with a severe chronic ailment, disease or disorder.

This amendment applies to 1997 and subsequent taxation years.

Subclause 23(4)

ITA
118.2(3)(*b*)

Paragraph 118.2(3)(*b*) of the Act provides that the amount of any reimbursement that is received for medical expenses, and that is not included in an individual's income, will reduce the amount of medical expenses that would otherwise be eligible for the medical expense tax credit. The amendment clarifies that this paragraph applies where the taxpayer seeking to claim the expenses, the patient or a person related to the taxpayer or the patient is entitled to a reimbursement in respect of the expenses.

This amendment applies to 1997 and subsequent taxation years.

Clause 24

Disability Tax Credit

ITA
118.3(1)(*a*.2)

Subsection 118.3(1) of the Act provides the formula for calculating the disability tax credit and the conditions for entitlement to the credit for those individuals with a severe and prolonged mental or physical impairment. Only medical doctors (and, in the case of a sight impairment, optometrists) are allowed to certify impairments under the existing Act. Under this amendment, audiologists will be authorized to certify a hearing impairment.

This amendment applies to certifications made after February 18, 1997.

Clause 25

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 for taxation years that end after November 1991, as these are the taxation years to which the amendment which deleted the reference applied. Also, effective after February 18, 1997,

it adds audiologists to the list of persons to whom subsection 118.4(2) applies.

Clause 26

Tuition Tax Credit

ITA
118.5(3)

Section 118.5 of the Act provides for a tax credit in respect of tuition fees paid to certain educational institutions. The amount of the credit is determined under subsection 118.5(1) by applying the appropriate percentage (17 per cent) to the eligible fees paid for an individual's tuition to a qualified institution where the total of such fees exceeds $100. This amendment allows an individual to claim as tuition fees certain ancillary fees and charges paid in respect of the individual's enrolment at a post-secondary educational institution if the payment of such fees or charges is made to the institution and is required from all of the institution's full-time students or part-time students, depending on whether the individual is enroled at the institution on a full-time or part-time basis.

Mandatory fees or charges do not qualify for the tuition tax credit to the extent that they are levied in relation to a student association, property to be acquired by students, services not ordinarily provided at post-secondary educational institutions in Canada or tax-exempt financial assistance to students. As well, mandatory charges paid for the construction, renovation or maintenance of a building or facility generally do not qualify for the credit. An exception is made to the extent that the building or facility is owned by the institution and is used to provide courses at the post-secondary school level or services that, if fees or charges were required to be paid by all of the institution's students for such services, the fees or charges would be eligible for the tuition tax credit.

Finally, where ancillary fees or charges paid in respect of an individual's enrolment at a post-secondary educational institution would qualify for the tuition fee credit, but for the fact that the payment of those fees or charges is not required from all of the institution's full-time students or part-time students, as the case may

be, an amount not in excess of $250 in respect of those fees may be included in computing the individual's tuition fee credit.

This amendment applies to the 1997 and subsequent taxation years.

Clause 27

Education Tax Credit

ITA
118.6(2)

Section 118.6 of the Act provides the education tax credit.

Subsection 118.6(2) of the Act contains the formula for calculating the amount of the credit. This amount is determined by multiplying the "appropriate percentage" (17 per cent) by $100 and by the number of months in the year during which the individual was enroled as a full-time student in a qualifying education program at a designated educational institution. This amendment, which applies to 1997 and subsequent taxation years, increases the monthly amount used in the formula to calculate the credit from $100 to $150 for 1997 and to $200 thereafter.

Clause 28

Carryforward of Tuition and Education Tax Credits

ITA
118.61

New section 118.61 of the Act provides for the carryforward of a student’s unused tuition and education tax credits.

Subsection 118.61(1) provides for the calculation of a student’s unused tuition and education tax credits at the end of a taxation year that may be carried forward to future taxation years for use by the student. That amount is determined by, first, adding to the student’s unused tuition and education tax credits at the end of the previous year (where that year is after 1996) the portion of the student’s

tuition and education credits for the current year that is not needed to eliminate the student's tax payable for the current year. This total is then reduced by the amount of the tuition and education tax credits carryforward that is deductible for the current year (which is, as set out in subsection 118.61(2), equal to the lesser of the previous year's carryforward and the tax that would be payable for the current year by the student if no tuition and education tax credits were allowed). Finally, this total is further reduced by the tuition and education tax credits transferred for the year by the student to the student's spouse, parent or grandparent.

This amendment applies to 1997 and subsequent taxation years.

Clause 29

Transfer of Unused Credits to Spouse

ITA
118.8

Section 118.8 of the Act governs the transfer to a spouse of certain unused tax credits. The credits which may be transferred are the tuition and education tax credits and the age, pension and disability tax credits. The amendments to section 118.8 are consequential on the introduction of the carryforward of the tuition and education tax credits under new section 118.61 of the Act. Starting with the 1997 taxation year, students will have the option of transferring the unused portion of their tuition and education tax credits or keeping it to reduce their own tax liability for future years. They will also be permitted to transfer part of the unused portion of these credits and carry forward the remainder.

This amendment applies to the 1997 and subsequent taxation years.

Clause 30

Transfer of the Tuition and Education Tax Credits

ITA
118.81

New section 118.81 of the Act provides for the calculation of the tuition and education tax credits that may be transferred for a taxation year from a student to the student's spouse under section 118.8 of the Act, or to a parent or grandparent under section 118.9 of the Act. The amount is determined by deducting from the lesser of $850 and the total of the student's tuition fee and education tax credits for the year the student's tax payable for the year, determined before claiming those credits.

This amendment applies to 1997 and subsequent taxation years.

Transfers to Parent or Grandparent

ITA
118.9

Section 118.9 of the Act governs the transfer of a student's tuition and education tax credits to the student's parent or grandparent. The amendment to section 118.9 is consequential on the introduction of the carryforward of the unused tuition and education tax credits under new section 118.61 of the Act. Starting with the 1997 taxation year, students will have the option of transferring the unused portion of their tuition and education tax credits or keeping it to reduce their own tax liability for future years. They will also be permitted to transfer part of the unused portion of these credits and carry forward the remainder.

This amendment applies to 1997 and subsequent taxation years.

Clause 31

Ordering of Credits

ITA
118.92

Section 118.92 of the Act provides that the tax credits allowed in computing any individual's tax payable are to be applied in a specific order. The amendment to this section adds a reference to section 118.61, which is the provision that allows for the carryforward of an individual's unused tuition and education tax credits under new section 118.61 of the Act.

This amendment applies to 1997 and subsequent taxation years.

Clause 32

Refundable Medical Expense Supplement

ITA
122.51

New section 122.51 of the Act provides a refundable tax credit for eligible individuals – the refundable medical expense supplement. The supplement is equal to the lesser of $500 and 25/17 of the medical expense tax credit claimed by an eligible individual for the year. The supplement is reduced by 5 per cent of the individual's "adjusted income" in excess of an indexed threshold ($16,069 for 1997).

For the purpose of the new medical expense supplement, "eligible individual" for a taxation year is defined in subsection 122.51(1) as an individual (other than a trust) who is resident in Canada throughout the year, 18 years of age or older at the end of the year and whose total business and employment income (excluding disability benefits) for the year is at least $2,500. The individual's "adjusted income" for a taxation year is also defined under this subsection as being the total, for the year, of the individual's income and that of a spouse cohabiting with the individual at the end of the year.

Subsection 122.51(2) provides that an individual's medical expense supplement for a taxation year is deemed to be paid on account of the individual's tax liability for the year. Thus, to the extent that the supplement exceeds the individual's tax otherwise payable for the year, it will be refunded to the individual.

These amendments apply to 1997 and subsequent taxation years.

Clause 33

Investment Tax Credit

Subclauses 33(1) to (3)

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.

"investment tax credit"

The definition of "investment tax credit" is amended to exclude expenditures in respect of which the taxpayer has not filed a prescribed form with Revenue Canada within one year after the taxpayer's filing-due date for the taxation year in which the expenditure was incurred. This requirement previously applied only to scientific research & experimental development investment tax credits.

This amendment applies to all taxation years, except that taxpayers who are not affected by the existing filing requirement in the definition of "qualified expenditure" in subsection 127(9) have until the date specified or May 31, 1997, whichever is later, to file the prescribed form.

"qualified expenditure"

The definition of "qualified expenditure" in subsection 127(9) of the Act is amended consequential on the amendment to the definition of "investment tax credit" to remove the filing requirement in

paragraph (*e*), which now appears in the amended definition of "investment tax credit" as described in the commentary on that provision.

The definition is also amended to clarify that the reference to an expenditure incurred by the taxpayer in respect of scientific research and experimental development in amended paragraph (*f*) can apply to an expenditure described in subparagraph 37(1)(*a*)(i.1) of the Act. Expenditures described in that paragraph (generally non-arm's length payments for SR&ED) do not qualify as SR&ED expenditures for the purposes of calculating the investment tax credit of the payer. Rather, the SR&ED performer is entitled to claim SR&ED benefits on its expenditures or, in certain circumstances, renounce those expenditures in favour of the payer by way of a joint election under subsection 127(13).

The definition is further amended by moving the exception to the exclusion from "qualified expenditure" contained in paragraph (*g*) to the end of the paragraph, to clarify that an expenditure described in the first part of that paragraph, which is an expenditure on SR&ED directly undertaken by the taxpayer, is not excluded as a qualified expenditure.

These amendments apply to taxation years that begin after 1995.

"taxable supplier"

This definition is amended to correct a formatting error which arose between the initial release of the draft legislation introducing this provision and the tabling of the Notice of Ways and Means Motion containing the provision in December 1995. The concluding portion "in the course of carrying on a business through a permanent establishment (as defined by regulation) in Canada" modifies both subparagraphs (*b*)(i) and (ii). This amendment applies to taxation years that begin after 1995.

Subclause 33(4)

ITA
127(11.4)

Subsection 127(11.4) of the Act was introduced contemporaneously with the introduction of the filing deadline for claiming SR&ED investment tax credits, to address the circumstances in which a taxpayer identified an amount as being a particular type of expense, but on reassessment Revenue Canada concluded that the amount should, instead, have been treated as SR&ED. In the absence of subsection 127(11.4), Revenue Canada could have been in the position of reassessing a taxpayer to disallow the classification made by the taxpayer, but also disallowing its classification as an SR&ED expense because it would be past the filing deadline.

In order to resolve this issue, subsection 127(11.4) of the existing Act provides that the filing deadline does not apply where Revenue Canada reclassifies an expenditure as SR&ED on an assessment of tax payable (or on a determination that no tax is owing). However, in order to ensure that taxpayers who do not file the required form on time are not accorded an inappropriate benefit because of a reassessment by Revenue Canada, subsection 127(11.4) is repealed for the 1997 and subsequent taxation years.

For the 1997 and subsequent taxation years, new subsection 37(12) of the Act will cause the affected expenditures to be treated, on an assessment by Revenue Canada, as if the SR&ED provisions did not exist. In most cases this will allow the taxpayer the original treatment claimed for the expenditure. Where that claim was also in error, Revenue Canada can assess to reflect the correct non-SR&ED classification of the expense.

As a transitional measure, subsection 127(11.4) is amended to refer to paragraph (*m*) of the definition "investment tax credit", consequential on the introduction of the filing deadline in the definition "investment tax credit" applicable for the 1996 taxation year.

Clause 34

Qualifying Environmental Trust

ITA
127.41

Section 127.41 of the Act provides a refundable tax credit to beneficiaries of a mining reclamation trust.

Section 127.41 is amended so that the reference to a "mining reclamation trust" is replaced by a broader reference to a "qualifying environmental trust". This amendment is in consequence of the extension of the rules for mining reclamation trusts reflected by the new definition "qualifying environmental trust" in subsection 248(1). For more details, see the commentary on that definition.

This amendment applies to taxation years that end after February 18, 1997.

Clause 35

Minimum Tax

ITA
127.52(1)(*d*)(i)

Paragraph 127.52(1)(*d*) of the Act provides that in computing an individual's adjusted taxable income for minimum tax purposes the total amount of capital gains and losses is to be taken into account. This is achieved through the direction in the paragraph to ignore the references in sections 38 and 41 to "3/4 of". This amendment exempts from the application of this rule gains resulting from charitable donations and other gifts for which a charitable donations deduction or tax credit may be claimed. The result is that only the reduced amount of any such taxable capital gain will be included in the base for determining an individual's minimum tax. This amendment applies to taxation years that begin after 1996.

Clause 36

Change of Residence

ITA
128.1(4)(*b*)(iii)

Subsection 128.1(4) of the Act provides a set of rules that apply to a taxpayer who ceases to be a resident of Canada. Under paragraph 128.1(4)(*b*), a taxpayer's property is generally treated in these circumstances as if it were disposed of at fair market value. Subparagraph 128.1(4)(*b*)(iii) provides an individual with an exemption from this deemed disposition where the property involved is a right to receive a pension benefit or certain other amounts described in subsection 212(1).

Subparagraph 128.1(4)(*b*)(iii) is amended to extend this exemption to rights under registered education savings plans.

This amendment applies to changes in residence after October 1, 1996.

Clause 37

Registered Retirement Savings Plans

ITA
146(1)

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

"earned income"

Subsection 146(1) defines "earned income" which is relevant in determining the maximum deduction in respect of premiums under an RRSP.

This amendment to the English version of the definition "earned income" is consequential on the amendment to paragraph 56(8)(*a*). It ensures that, while all types of benefits received under the Canada

and Quebec Pension Plans may be eligible for the special tax treatment provided under that paragraph, only disability pensions paid under those plans may be included in computing an individual's earned income for RRSP purposes.

This amendment applies to amounts received after 1994.

ITA
146(1)

"RRSP deduction limit"

Subsection 146(1) of the Act defines "RRSP deduction limit", which 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 defined to be the amount determined by the formula

$$A + B - C$$

where

A = the amount of the individual's unused RRSP deduction room carried forward from the previous year,

B = the amount of new RRSP deduction room that becomes available to the individual in the year (based on the individual's earned income for the previous year and certain other factors), and

C = the amount of the individual's net past service pension adjustment for the year.

This definition is amended in two ways. First, the formula is amended, for the 1998 and subsequent taxation years, to add an amount (variable R) which is described as the individual's total pension adjustment reversal for the year. The Income Tax Regulations will be amended to define an individual's total pension adjustment reversal for a year as the sum of the individual's pension adjustment reversals (PARs) for the year under deferred profit

sharing plans (DPSPs) and benefit provisions of registered pension plans (RPPs).

The Regulations will also be amended to provide rules for the calculation of PARs. Under those rules, the determination of an individual's PAR under a DPSP or benefit provision of an RPP will usually be required where the individual ceases, after 1996 and before retirement, to be entitled to benefits under the plan or provision. In general terms, an individual's PAR under a defined benefit provision of an RPP will be the total of the individual's pension credits and past service pension adjustments under the provision since 1990, minus any lump sum amounts paid to the individual, or transferred to an RRSP or other money purchase type of registered plan, in respect of the individual's post-1989 benefits under the provision. An individual's PAR under a DPSP or money purchase provision of an RPP will be the total of all amounts included in the individual's pension credits under the plan or provision since 1990 but not vested in the individual.

The Regulations will generally require that an individual's PAR be reported to Revenue Canada and to the individual within 60 days after the calendar year quarter in which the individual ceases to be entitled to benefits under the DPSP or the benefit provision of the RPP, as the case may be. However, for those individuals who cease to be entitled to benefits after 1996 and before October 1998, the reporting deadline will be extended to December 31, 1998. The Regulations will require that PARs be reported by the plan administrator in the case of an RPP, and by the plan trustees in the case of a DPSP. PAR will be included in the individual's total pension adjustment reversal for the year in which the individual's entitlement to benefits ceases (except where entitlement ceases in 1997, in which case the resulting PAR will be added to the individual's total pension adjustment reversal for 1998).

The second amendment to the definition "RRSP deduction limit" is technical. It clarifies that, where an amount is prescribed in respect of an individual for a year for purposes of the description of B, the amount is subtracted in determining the value of B. This amendment applies after 1988, which coincides with the introduction of the definition "RRSP deduction limit".

ITA
146(1)

"unused RRSP deduction room"

Subsection 146(1) defines "unused RRSP deduction room", which measures the amount of deduction room for RRSP contributions that an individual may carry forward from a year to use in future years.

An individual's unused RRSP deduction room at the end of a year is defined to be the amount determined by the formula

$$A + B - (C + D)$$

where

A = the amount of the individual's unused RRSP deduction room carried forward from the previous year,

B = the amount of new RRSP deduction room that becomes available to the individual in the year (based on the individual's earned income for the previous year and certain other factors),

C = the amount of the individual's net past service pension adjustment for the year, and

D = the amount of any RRSP contributions deducted by the individual in computing income for the year.

This definition is amended in two ways. First, the formula is amended, for the 1998 and subsequent taxation years, to add an amount (variable R) which is the individual's total pension adjustment reversal for the year. See the commentary on the amendments to the definition "RRSP deduction limit" in subsection 146(1) for further information.

The second amendment is technical. It clarifies that, where an amount is prescribed in respect of an individual for a year for purposes of the description of B, the amount is subtracted in determining the value of B. This amendment applies after 1988,

which coincides with the introduction of the definition "unused RRSP deduction room".

Clause 38

Registered Education Savings Plans

ITA
146.1

Section 146.1 of the Act contains rules relating to registered education savings plans (RESPs). Significant amendments are being made to this section: to increase the annual contribution limit; to allow an RESP subscriber to receive the trust's accumulated income under certain circumstances; to permit RESP beneficiaries who are enroled in a distance education course to receive educational assistance payments; and to allow spouses to be joint subscribers under an RESP. Additional technical amendments are being made to improve the operation of the RESP rules.

Overview

The federal budget of February 18, 1997 announced significant changes to the rules governing RESPs. The purpose of this overview is to provide an outline of the existing rules governing RESPs, together with the proposed changes. For technical detail, reference should be made to proposed section 146.1 and Parts X.4 and X.5 of the Act and to the detailed explanatory notes with respect to those provisions. It must be stressed that, while the Act provides a basic framework for RESPs, the actual benefits provided under a specific RESP depend on its terms.

Q1. What are RESPs?

RESPs are vehicles designed for individuals to accumulate income for post-secondary education. Typically, the plans are entered into by parents seeking to save for their children's post-secondary education.

There are currently two basic types of RESPs. A qualifying child can be a beneficiary under a plan (sometimes referred to as a "group RESP") under which benefits are a proportionate share of income

accumulating in respect of a group of children of the same age. In this case, contributions are made in respect of each such child under similar RESPs with the same promoter and the benefits for a child vary depending on the timing and amounts of contributions made in respect of the child and the investment performance of assets associated with the plan. A child or adult, alone or with family members, can also be a beneficiary under RESPs that are sometimes referred to as "self-directed" or "individual" RESPs.

An RESP is entered into between an RESP promoter and a subscriber. A subscriber can establish an RESP for the benefit of any number of beneficiaries. Where there is more than one beneficiary under a single plan, each beneficiary under the plan must be related to the subscriber by blood relationship or adoption. For example, an individual cannot establish an RESP for the individual's own benefit or the benefit of the individual's spouse unless there is only one beneficiary. However, a parent can establish an RESP for the benefit of all his or her children.

Q2. What are the contribution limits for RESPs?

The existing annual contribution limit per beneficiary is $2,000. The proposed amendments increase the $2,000 limit to $4,000 for 1997 and subsequent taxation years. The lifetime contribution limit per beneficiary remains at $42,000.

It should be noted that the contribution limits cannot be avoided by establishing more than one RESP or by having different subscribers establish RESPs. For example, if a grandparent contributed $1,500 into an RESP in respect of a grandchild in a year, the remaining RESP contribution room available to any other subscriber in respect of the grandchild in the year would be $2,500.

Q3. Can RESP income and RESP contributions be returned to a subscriber?

There is nothing in the Act which would prevent RESP contributions from being returned to a subscriber. Conversely, under the existing rules in the Act, RESP income cannot be returned to a subscriber, except by way of educational assistance payments. Educational assistance payments can generally be paid only to students in full-time attendance at a university or college, although the

amendments will accommodate distance education by allowing such payments to be made to students taking a full-time course load at a university or college.

The amendments permit an RESP to make a distribution at any time after 1997 of accumulated income to a subscriber where the following conditions are met:

- the subscriber is resident in Canada,
- each beneficiary in respect of whom contributions were made by the subscriber has attained 21 years of age and is not eligible at that time to receive educational assistance payments, and
- the RESP has been in existence for at least 10 years.

After a subscriber's death, an RESP may allow for the distribution of accumulated income to any person resident in Canada. In addition, the "age 21" and "10 year hold" conditions are waived in the case of deceased beneficiaries.

It should also be noted that RESP assets can be transferred from one RESP to another without restarting the 10 year hold requirement.

Q4. What is the tax treatment of RESP contributions?

RESP contributions are not deductible in computing income. They can be returned to the subscriber at any time without tax consequences, in accordance with the terms of the RESP.

Q5. What is the tax treatment of RESP income?

RESP income is included in computing a recipient's income once it is distributed, and taxed accordingly. However, in many cases the recipient will be a student whose total income will result in a minimal amount of tax. The tax advantage of an RESP is that tax is not levied on an annual basis on undistributed RESP income.

When RESP income is returned to a subscriber under the new rules, an additional 20-per-cent tax is levied on the subscriber except to the extent that the subscriber "rolls over" the RESP income to an RRSP as described below. The 20-per-cent tax is in recognition of the

deferral of taxes on interest and other income on funds contributed into an RESP. For example, assume $1,000 of RESP income is distributed to a subscriber whose marginal federal/provincial combined income tax rate is 50 per cent, the subscriber will pay $500 of regular income tax and an additional $200 of penalty tax.

If, after the death of a subscriber, income is returned under the new rules to an individual other than the spouse or former spouse of the deceased subscriber, the 20-per-cent tax will apply with respect to such income.

Q6. Can the 20-per-cent penalty tax be avoided by transferring RESP income to an RRSP?

When RESP income is transferred on behalf of a subscriber into an RRSP, the RESP income is still included in computing the subscriber's income. However, the amount transferred into the RRSP counts as a normal RRSP contribution which can offset the income inclusion and eliminate the 20-per-cent penalty tax if the subscriber has sufficient unused RRSP room. Subject to a lifetime limit of $40,000, RESP income transferred into an RRSP will generally not be subject to the 20-per-cent penalty tax, provided that the subscriber deducts a regular RRSP contribution for the year of the transfer equal to at least the amount of the transfer. **Note: If a transfer of RESP income is made in the first 60 days of a taxation year, the 20-per-cent tax will be reduced only in the event that the transfer is deducted in computing income for that year.**

The proposed amendments will provide the authority to impose withholding taxes with respect to RESPs. However, to accommodate transfers of RESP income to RRSPs, provision to waive withholding taxes will be made in some cases.

Q7. Can the 20-per-cent penalty tax also be avoided by transferring RESP income to a spousal RRSP of an RESP subscriber?

Yes, provided the RESP subscriber has sufficient RRSP deduction room.

Q8. What if the RESP contribution limits are exceeded?

Subscribers are required to report overcontributions in respect of a beneficiary, based on contributions to all plans in respect of the beneficiary. There is a 1 per cent per month penalty tax in respect of excess amounts.

In addition, the registration of an RESP will become revocable in the event that an excess contribution is made in respect of a beneficiary. However, it is expected that the Minister of National Revenue would generally revoke a plan on this basis only in cases where there has been a flagrant disregard of the contribution limits.

Q9. What happens if an overcontribution to an RESP is made by mistake?

The Minister of National Revenue will have discretion to waive the penalty tax.

Q10. Can property be transferred from one RESP to another?

In most situations, a transfer from one RESP to another will not have any adverse consequences. Transfers can be made without any resulting taxes or penalties where there is a common beneficiary under the transferor and transferee plan. In addition, this rule will be extended to cases where a beneficiary under the transferor plan is a sibling of a beneficiary under the transferee plan, provided that the beneficiary under the transferee plan is under 21 years of age.

In situations not described above, transfers can result in penalty tax because the RESP contribution history in respect of each beneficiary under a transferor plan will, in effect, be assumed by each beneficiary under the transferee plan. As a consequence, each contribution that was made into the transferor plan is treated on a retroactive basis as also having been made into the transferee plan.

Similar rules will also apply where one beneficiary replaces another beneficiary under the same plan.

Q11. Will RESPs have to be changed because of the proposed amendments to allow distributions of accumulated income?

No. On the other hand, the amendments will not prevent any change in the terms of existing RESPs. An existing arrangement could be altered where the parties to the arrangement agree. In addition, it is understood that "group" RESPs normally have specific contractual provisions governing modifications to existing arrangements.

ITA
146.1(1)

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

Subclause 38(1)

"pre-1972 income" and "tax-paid income"

These definitions are being repealed, effective after 1997. For further details, see the commentary on the repeal of subsections 146.1(8) to (10) of the Act.

Subclause 38(2)

"educational assistance payment"

An "educational assistance payment" is a payment, other than a refund of payments, made to a designated beneficiary under an education savings plan to assist the beneficiary to further his or her post-secondary education. Educational assistance payments are included in computing income under subsection 146.1(7). Paragraph 146.1(2)(*g*) and new paragraph 146.1(2)(*g*.1) are RESP registration rules which restrict the circumstances in which educational assistance payments can be made.

The definition is amended so that scholarships and other similar amounts paid out of an education savings plan to non-beneficiaries will also be treated as educational assistance payments. As indicated by existing paragraph (*b*) of the definition "trust" in

subsection 146.1(1), payments of this nature to non-beneficiaries are contemplated under the RESP rules.

This amendment applies after 1997.

"education savings plan"

An RESP is an "education savings plan" that has been accepted for registration by the Minister of National Revenue. An "education savings plan" is defined as a contract between an individual who is the subscriber, and a person or organization who is the promoter. Under the terms of the contract, the subscriber makes contributions to the promoter in exchange for, among other things, the promoter's undertaking to make educational assistance payments to eligible beneficiaries.

The definition is amended to provide that the contract may be entered into jointly by an individual and the individual's spouse. It is also amended to prohibit a trust (which is treated as an individual for the purposes of the Act) from establishing an RESP. The existing reference to a "subscriber" within the definition has also been replaced by a new definition of "subscriber", which is explained in the commentary on that provision.

These amendments apply to contracts made after 1997.

"refund of payments"

A "refund of payments" under an education savings plan is essentially a return of all or part of the contributions made by or on behalf of a subscriber under the plan.

The definition is amended to clarify that a "refund of payments" under a plan also includes an amount transferred from another plan to the extent that the amount would have been a "refund of payments" if it had been paid directly to a subscriber under the other plan.

This amendment applies to 1997 and subsequent taxation years.

"registered education savings plan"

A "registered education savings plan" is an education savings plan that has been accepted for registration by Revenue Canada.

The definition is amended so that an RESP that is amended subsequent to registration continues to be considered to be an RESP. The definition is also amended to provide that, once the registration of an education savings plan has been revoked under amended subsection 146.1(13), the plan is no longer treated as an RESP (except for the purposes of the income inclusion rules in subsections 146.1(7) and (7.1) and the overcontribution tax in Part X.4 of the Act). This exception ensures that educational assistance payments and accumulated income payments made under a revoked plan will be included in the recipient's income.

These amendments apply after 1997.

Subclause 38(3)

"trust"

For the purpose of the RESP rules, a "trust" is defined to be any person who irrevocably holds property pursuant to an education savings plan for a number of limited purposes. Under paragraph (*b*) of the definition, one of the permitted purposes of an RESP trust is the payment of scholarships to non-beneficiaries.

Paragraph (*b*) of the definition is being eliminated. This amendment is consequential on an amendment to the definition "educational assistance payment", under which payments of scholarships and other amounts to non-beneficiaries will be treated as educational assistance payments. For further detail, see the commentary on the amendments to the definition "educational assistance payment".

The definition is also amended so that after 1997 a trust is permitted to provide for the payment of accumulated income payments. For further details, see the commentary on the new definition of "accumulated income payment".

These amendments apply after 1997.

Subclause 38(4)

"accumulated income payment"

The definition "accumulated income payment" is being introduced, effective after 1997. It is any distribution out of an education savings plan, other than a distribution that is an educational assistance payment, a refund of payments, a payment to an educational institution in Canada or a transfer to another RESP.

Accumulated income payments are required under new subsection 146.1(7.1) of the Act to be included in computing the recipient's income and are relevant in computing the special 20-per-cent tax in new Part X.5 of the Act. The circumstances in which such payments can be made is limited by new paragraph 146.1(2)(*d*.1).

"RESP annual limit"

The definition "RESP annual limit" is introduced, effective after 1989. It represents the maximum annual amount that can be contributed to an RESP in a year in respect of a beneficiary. The amount was $1,500 from 1990 to 1995 and $2,000 for 1996 and will be $4,000 for 1997 and subsequent years. The definition is used in amended paragraph 146.1(2)(*k*) and amended Part X.4 of the Act.

"subscriber"

The existing definition "subscriber", contained within the definition of "education savings plan", defines a subscriber simply as the individual who entered into the RESP contract with the promoter.

A separate definition of "subscriber" is being introduced, effective for contracts entered into after 1997. Generally, a subscriber under an education savings plan is the individual (or individuals) with whom the promoter entered into the plan. The definition also provides for replacement subscribers under certain circumstances relating to marriage breakdown and death, as described below.

Where a spouse or former spouse of a subscriber acquires the subscriber's rights under the plan pursuant to a court order or written agreement relating to a division of property between the two

individuals on the breakdown of their marriage, the spouse or former spouse is considered to be a subscriber under the plan. In such a case, the former subscriber ceases to be a subscriber under the plan.

Also, where the plan allows a person to make contributions into the plan after the death of a subscriber, the person is a subscriber under the plan. For example, if the estate of the subscriber continues to make contributions into the plan in respect of the plan's beneficiaries, the estate is considered to be a subscriber.

The definition is relevant for a number of purposes. Under new paragraph 146.1(2)(*d*.1), an RESP may allow a subscriber to receive "accumulated income payments". Under amended Part X.4 of the Act, the liability for RESP overcontributions tax is imposed on RESP subscribers.

Subclause 38(5)

ITA
146.1(2)

Subsection 146.1(2) of the Act sets out the requirements that must be satisfied in order to register an education savings plan. The preamble to subsection 146.1(2) is amended to make it clear that the requirements in that subsection do not simply relate to the terms of an education savings plan. This amendment is, in part, consequential on the amendment to paragraph 146.1(2)(*m*) described in the commentary below.

This amendment applies to applications made after 1997.
Other amendments to subsection 146.1(2) are described in the commentary below.

Subclause 38(6)

ITA
146.1(2)(*b*)

Paragraph 146.1(2)(*b*) of the Act requires that, before an education savings plan may be registered, there must be at least 150 subscribers who have entered into plans with the promoter which meet all the

other requirements of subsection 146.1(2). Note, however, that relief from this requirement is provided under subsection 146.1(3).

Paragraph 146.1(2)(*b*) is amended by changing the requirement that there be at least 150 subscribers who have entered into plans with the promoter to a requirement that there be at least 150 plans entered into with the promoter. Paragraph 146.1(2)(*b*) is also amended to eliminate an unnecessary reference to the former Act.

These amendments apply to applications made after 1997.

Subclause 38(7)

ITA
146.1(2)(*d*) and (*d*.1)

Paragraph 146.1(2)(*d*) of the Act ensures that payments to a subscriber under a plan are restricted to a refund of payments (unless the subscriber is also the beneficiary under the plan). Under the existing rules, subscribers generally forfeit RESP income in the event the designated beneficiaries do not pursue post-secondary education.

Paragraph 146.1(2)(*d*) is amended so that the restriction applies only to payments made to a subscriber under a plan before 1998. This amendment is consequential on the introduction of new paragraph 146.1(2)(*d*.1) of the Act which permits RESP income to be returned to a subscriber where certain conditions are satisfied.

New paragraph 146.1(2)(*d*.1) is added to allow, but not require, RESPs to be established or amended so that subscribers (and other persons) can receive RESP income under certain circumstances. An RESP may provide after 1997 for the payment of "accumulated income payments" (as defined in subsection 146.1(1)) to or on behalf of a person resident in Canada. Generally, the person must be a subscriber under the plan. However, where a subscriber has died, the plan may allow accumulated income payments to be made to any person resident in Canada.

Where more than one person is entitled to receive accumulated income payments under a plan, the payments must be made separately to each person. The plan must not allow for the payments to be made jointly.

In addition, the following conditions must be satisfied at the time an accumulated income payment is made:

- each individual in respect of whom a contribution had been made into the plan has attained 21 years of age and is not pursuing post-secondary education (or each such individual is deceased); and

- the plan has been in existence for at least 10 years (or each individual in respect of whom a contribution had been made into the plan is deceased and was the subscriber, was related to a subscriber, or was the nephew, niece, great nephew or great niece of a subscriber).

New subsection 146.1(7.1) requires the inclusion in income of accumulated income payments received under an RESP. In addition, new Part X.5 of the Act sets out a special tax on accumulated income payments.

These amendments apply to 1998 and subsequent taxation years.

Subclause 38(8)

ITA
146.1(2)(*g*) and (*g*.1)

Paragraph 146.1(2)(*g*) of the Act provides that educational assistance payments to beneficiaries of RESPs may be made only where the beneficiary is a student in full-time attendance at a post-secondary institution and enroled in a qualifying educational program.

Paragraph 146.1(2)(*g*) is amended so that it applies only with respect to payments made before 1997. This amendment is consequential on the introduction of new paragraph 146.1(2)(*g*.1).

New paragraph 146.1(2)(*g*.1) provides that educational assistance payments made after 1996 to an individual under an RESP may be made only where the individual is enrolled in a qualifying educational program as a full-time student at a post-secondary educational institution. As a result, educational assistance payments may now be made out of an RESP to students who are taking distance education courses, such as correspondence courses.

Amended paragraph 146.1(2)(*g*) and new paragraph 146.1(2)(*g*.1) apply to plans entered into after February 20, 1990. However, for plans entered into before 1998, the restrictions do not apply to students who are not designated RESP beneficiaries.

ITA
146.1(2)(*g*.2)

New paragraph 146.1(2)(*g*.2) of the Act requires that each contribution made into an RESP either be a subscriber contribution made in respect of a beneficiary under the plan, or a transfer from another RESP.

This amendment applies to 1997 and subsequent taxation years.

Subclause 38(9)

ITA
146.1(2)(*i*.1)

New paragraph 146.1(2)(*i*.1) of the Act applies only with respect to an RESP that allows for the payment of accumulated income payments. Where a plan allows such payments, the plan must provide for its termination on or before March of the year following the year in which the first such payment is made.

This amendment applies to 1998 and subsequent taxation years.

ITA
146.1(2)(*i*.2)

New paragraph 146.1(2)(*i*.2) of the Act prohibits a plan from receiving property from another RESP after the other plan has made an accumulated income payment. This condition ensures that transfers between plans cannot be used to extend the life of a plan beyond the term provided for in new paragraph 146.1(2)(*i*.1).

This amendment applies to 1998 and subsequent taxation years.

ITA
146.1(2)(*j*)

Paragraph 146.1(2)(*j*) of the Act restricts the selection of RESP beneficiaries, where a plan permits more than one individual to be a beneficiary. Where this is the case, the subscriber must be connected by blood relationship or adoption to each of the beneficiaries. Subsection 251(6) provides rules for determining connection by blood relationship and adoption.

Paragraph 146.1(2)(*j*) is amended to ensure that this restriction operates as intended where an RESP has more than one subscriber. Where this is the case and there is more than one beneficiary, each of the beneficiaries must be connected by blood relationship or adoption to each of the living subscribers (or to have been connected to a deceased original subscriber). This amendment relates to an amendment to the definition "education savings plan" in subsection 146.1(1), which contemplates an RESP having joint subscribers.

Subparagraph 146.1(2)(*j*)(ii) is introduced to restrict the contributions that can be made in respect of a beneficiary, in the event that an RESP allows more than one beneficiary. A contribution into the plan in respect of a beneficiary in these circumstances is permitted to be made only where:

- the beneficiary has not attained 21 years of age at the time the plan was entered into, or

- the contribution is made by way of a transfer from another RESP or after such a contribution, provided that another contribution in respect of the beneficiary had been made before the transfer into the other plan.

While special provision is made above for transfers from another RESP, new paragraph 146.1(2)(*g*.2) does not allow a plan to accept contributions into the plan by way of a transfer from another education savings plan in the event that the registration of the other plan has been revoked. The registration of the other plan will be revocable under subsections 146.1(12.1) to (13) in the event that the other plan does not comply with new subparagraph 146.1(2)(*j*)(ii).

These amendments generally apply to 1998 and subsequent taxation years. However, the whole of paragraph 146.1(2)(*j*) does not apply to plans entered into before July 14, 1990. In addition, subparagraph 146.1(2)(*j*)(ii) does not apply to plans entered into before 1998.

Subclause 38(10)

ITA
146.1(2)(*k*)

Paragraph 146.1(2)(*k*) of the Act ensures that an RESP will not accept contributions in respect of a beneficiary which exceed $2,000 per year.

Paragraph 146.1(2)(*k*) is amended to raise this limit to the RESP annual limit. As defined in subsection 146.1(1), the RESP annual limit for the 1997 and subsequent years is $4,000.

Paragraph 146.1(2)(*k*) is also amended so that, for the purpose of this paragraph, contributions made by way of a transfer from another RESP do not use up this limit. Note, however, that RESP overcontributions may result in a penalty tax for the subscriber under Part X.4 of the Act.

These amendments apply to plans entered into after February 20, 1990.

Subclause 38(11)

ITA
146.1(2)(*m*)

Paragraph 146.1(2)(*m*) of the Act requires that an RESP comply with prescribed conditions. There are no conditions currently prescribed for this purpose.

Paragraph 146.1(2)(*m*) is replaced by a further condition for registration of an education savings plan. For an education savings plan to be accepted for registration, the Minister of National Revenue must have no reasonable basis to believe that the promoter will not

take all reasonable measures to ensure that the plan will continue to comply with the plan registration conditions.

This amendment applies to applications made after 1997.

Subclause 38(12)

ITA
146.1(4.1)

New subsection 146.1(4.1) of the Act applies where an RESP is amended. It requires the promoter to file the text of the amendment with Revenue Canada within 60 days after the plan is amended. The penalty for failure to comply with this requirement is provided under subsection 162(7) of the Act.

The requirement to file RESP amendments does not apply until Royal Assent. However, Revenue Canada currently requires, in paragraph 27 of Information Circular 93-3, that amendments be submitted.

Subclause 38(13)

ITA
146.1(6.1)(*a*)

Subsection 146.1(6.1) of the Act contains special rules that apply with respect to transfers of property from one RESP to another.

Paragraph 146.1(6.1)(*a*) ensures that RESP transfers will not result in penalty tax under Part X.4 of the Act. Paragraph 146.1(6)(*a*) is repealed, effective for transfers that occur after 1996. This amendment is consequential on the introduction of subsection 204.9(5) of the Act.

Subclause 38(14)

ITA
146.1(6.1)(*b*) and (*c*)

Paragraph 146.1(6.1)(*b*) of the Act ensures that transfers from one RESP to another cannot be used to avoid specified registration

conditions. It provides that, for the purposes of paragraphs 146.1(2)(*h*) and (*i*), the transferee plan is deemed to have been entered into on the earlier of the day otherwise determined and the day on which the transferor plan was entered into.

Paragraph 146.1(6.1)(*b*) is amended so that this deeming rule also applies for the purpose of new subparagraph 146.1(2)(*d*.1)(vi) of the Act, which generally prohibits distributions of RESP accumulated income from plans that have existed for less than 10 years. This ensures that property can be transferred from one RESP to another without restarting the "10 year hold" requirement. Amended paragraph 146.1(6.1)(*b*) applies after 1997.

New paragraph 146.1(6.1)(*c*) of the Act, which applies to transfers that occur after 1997, exempts transferred amounts from being included in computing the income of any person.

Subclause 38(15)

ITA
146.1(7)

Subsection 146.1(7) of the Act requires that an RESP beneficiary include in income for a taxation year the total of all educational assistance payments paid to, or on behalf of, the beneficiary in the year under the plan, excluding the beneficiary's portion of "tax-paid-income".

Subsection 146.1(7) is amended so that educational assistance payments paid out of an RESP to or for any individual are included in computing the individual's income. This ensures that non-beneficiaries who receive scholarships under the plan are required to include such amounts in computing their income.
Subsection 146.1(7) is also amended to delete the provisions relating to "tax-paid-income" as they are no longer relevant. For further details, see the commentary on subsections 146.1(8) to (10) of the Act.

These amendments apply to 1998 and subsequent taxation years.

ITA
146.1(7.1) and (7.2)

New subsection 146.1(7.1) of the Act provides that accumulated income payments received by a taxpayer in a taxation year under an RESP are required to be included in computing the taxpayer's income for the year.

In order to discourage the trading of RESP interests, subsection 146.1(7.1) also provides that any amounts received by a taxpayer in a year from the disposition of a subscriber's interest under an RESP, other than amounts excluded by virtue of new subsection 146.1(7.2), are included in the taxpayer's income for the year. For this purpose, the following amounts are excluded:

- any amount received under the plan;
- any amount received in satisfaction of a right to a refund of payments; and
- any amount received under a court order or written agreement relating to a division of property between two individuals on the breakdown of their marriage.

These amendments apply to 1998 and subsequent taxation years.

ITA
146.1(8) to (10)

Subsections 146.1(8) to (10) of the Act contain income exclusion rules that apply with respect to the distribution of property relating to pre-1972 income of a trust governed by an education savings plan. To the extent that trust income earned prior to 1972 had been included in the subscriber's income, the rules provide a deduction for the portion of "tax-paid-income" included in payments to a beneficiary under the plan.

Subsections 146.1(8) to (10) are repealed for 1998 and subsequent taxation years as they are no longer relevant, since all pre-1972 plans would be expected to have been wound up by this time.

Subclause 38(16)

ITA
146.1(12.1) to (13)

Subsection 146.1(13) of the Act permits the Minister of National Revenue to revoke the registration of an RESP that ceases to comply with the requirements for registration. The existing rules are amended to improve the procedure for revoking the registration of an RESP. The new rules are similar to those found in section 147.1 of the Act that apply to the revocation of the registration of a pension plan.

New subsection 146.1(12.1) of the Act provides that the Minister may revoke the registration of an RESP if:

- the plan ceases to comply with the conditions for its registration;
- the plan ceases to comply with any provision of the plan; or
- an individual has become liable for tax under Part X.4 of the Act because of contributions into the plan.

As a first step in revoking the registration of an RESP, the Minister must notify the promoter in writing of the Minister's intention to revoke the plan's registration as of a specified day. The day can be no earlier than the day of the failure that entitles the Minister to send the notice of intent, or the last day of the month for which tax under Part X.4 of the Act is payable, as the case may be. Upon receipt of such a notice, the promoter under the plan may, under amended subsection 172(3) of the Act, appeal to the Federal Court of Appeal.

New subsection 146.1(12.2) provides that, after the Minister has sent a notice of intent to revoke the registration of an RESP, the Minister may notify the promoter in writing that the registration of the plan is revoked as of a specified date, which day can be no earlier than the day stated in the notice of intent. The notice of revocation cannot be sent until 30 days after the notice of intent was sent.

Amended subsection 146.1(13) provides that the registration of an RESP is revoked as of the day specified in the Minister's notice of revocation sent under subsection 146.1(12.2) unless, in the course of

an appeal under subsection 172(3), the Federal Court of Appeal orders otherwise.

These amendments apply after 1997.

ITA
146.1(14)

A trust governed by a revoked RESP is subject to tax under Part I of the Act on its taxable income. Any distributions from the revoked RESP as educational assistance payments or accumulated income payments are required to be included in the recipient's income pursuant to subsections 146.1(7) and (7.1) of the Act. In addition, distributions from a revoked RESP may give rise to penalty tax under new Part X.5 of the Act. Existing subsection 146.1(14) provides for an amount to be included in computing the income of a subscriber upon the revocation of an RESP.

Subsection 146.1(14) is being repealed, effective after 1997. It is no longer considered necessary in light of the other tax implications described above with respect to revoked RESPs.

Subclause 38(17)

ITA
146.1(15)

New subsection 146.1(15) of the Act allows the Governor in Council to make regulations requiring promoters to file information returns relating to education savings plans.

This amendment applies on Royal Assent.

Clause 39

Registered Pension Plans

ITA
147.1(18)

Paragraph 147.1(18)(*d*) of the Act allows the Governor in Council to make regulations requiring registered pension plan administrators to make determinations relating to the computation of pension adjustments and past service pension adjustments. This paragraph is amended to include, after 1996, a reference to total pension adjustment reversals.

Paragraph 147.1(18)(*t*) of the Act allows the Governor in Council to make regulations defining several expressions used in the Act, such as "pension adjustment" and "past service pension adjustment". This paragraph is amended to include, after 1996, a reference to "total pension adjustment reversal".

See the commentary on the amendments to the definition "RRSP deduction limit" in subsection 146(1) of the Act for further information.

Clause 40

Transfer of Property within a Registered Pension Plan

ITA
147.3(14.1)

Existing subsections 147.3(9) to (11) of the Act set out the tax consequences associated with transfers between registered pension plans (RPPs) and transfers from an RPP to a registered retirement savings plan or to a registered retirement income fund. With the introduction of new subsection 147.3(14.1), subsections 147.3(9) to (11) are also made to apply to transfers between benefit provisions of the same RPP.

Specifically, new subsection 147.3(14.1) provides that, where property held under one benefit provision of an RPP is made

available to pay benefits under another benefit provision of the same plan, subsections 147.3(9) to (11) apply in the same manner as they would have applied if the provisions had been in separate RPPs.

This means that, where an amount is transferred on behalf of an individual from one benefit provision to another of the same RPP and the transfer would not be in accordance with any of subsections 147.3(1) to (7) of the Act, the amount is deemed to have been paid from the plan to the individual and, as such, is taxable. The amount is also deemed to have been paid by the individual to the plan as a contribution under the recipient provision.

It should be noted that, by virtue of subsection 147.3(14) read in conjunction with subsection 147.3(14.1), subsections 147.3(9) to (11) also apply where property held under one benefit provision is made available to pay benefits under another benefit provision of the same RPP without the property being actually transferred.

New subsection 147.3(14.1) applies to transactions occurring on or after July 31, 1997.

Clause 41

Exemptions from Tax

ITA
149(1)(*z*)

Paragraph 149(1)(*z*) of the Act exempts mining reclamation trusts from tax under Part I of the Act. Instead, these trusts are taxed under Part XII.4.

Paragraph 149(1)(*z*) is amended so that the reference to a "mining reclamation trust" is replaced by a broader reference to a "qualifying environmental trust". This amendment is in consequence of the extension of the rules for mining reclamation trusts reflected by the new definition "qualifying environmental trust" in subsection 248(1). For more details, see the commentary on that definition.

This amendment applies to the 1997 and subsequent taxation years.

Clause 41.1

National Arts Services Organizations

ITA
149.1(6.4)

Subsection 149.1(6.4) of the Act provides that a national arts service organization that is designated by the Minister of Canadian Heritage and registered by the Minister of National Revenue as meeting prescribed criteria shall, for the purpose of certain provisions of the Act, be treated as a registered charity that is designated as a charitable organization. This amendment adds paragraph 38(*a*.1) of the Act to the list of those provisions so that capital gains resulting from the making of gifts to national arts service organizations may qualify for the lower income inclusion rate provided in that paragraph.

This amendment applies after February 18, 1997.

Clause 42

Assessment

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 of amounts of tax deemed to have been paid by a taxpayer.

Subclause 42(1)

ITA
152(1)(*b*)

Subsection 152(1) of the Act lists certain refunds and deemed payments of tax that are to be determined by Revenue Canada in the course of assessing a taxpayer's tax return.

Paragraph 152(1)(*b*) refers to the specific provisions of the Act under which amounts are deemed to be paid on account of tax. The amendment to this paragraph adds a reference to subsection 122.51(2) which is the provision under which the new refundable medical expense supplement is granted. The amendment also deletes obsolete references.

This amendment generally applies to 1997 and subsequent taxation years.

Paragraph 152(1)(*b*) is also amended to add a reference to new subsection 125.5(3) of the Act, under which qualified corporations may be deemed to have paid an amount on account of federal income tax as a result of the film or video production services tax credit. For further detail, please see the commentary on that provision in notes to Division B of these amendments.

This amendment applies to taxation years that end after October, 1997.

Subclause 42(2)

ITA
152(4.2)(*d*)

Subsection 152(4.2) of the Act gives Revenue Canada discretion to make a reassessment or a redetermination beyond the normal reassessment period when so requested by a taxpayer who is an individual or a testamentary trust in order to give the taxpayer a refund or to reduce taxes payable. The amendment to paragraph 152(4.2)(*d*) adds a reference to subsection 122.51(2) to enable Revenue Canada to make a redetermination of the new refundable medical expense supplement. The amendment also deletes obsolete references.

These amendments apply to 1997 and subsequent taxation years.

Clause 43

Withholding of Tax

ITA
153(1)

Subsection 153(1) of the Act authorizes regulations for the withholding of tax from the payments described in paragraphs 153(1)(*a*) to (*r*).

Paragraph 153(1)(*s*) is added to authorize the withholding of tax from amounts in respect of employment earnings supplements, which are dealt with in paragraph 56(1)(*r*) of the Act. This amendment applies to payments made after 1992.

Paragraph 153(1)(*t*) is added to authorize the withholding of tax from payments under registered education savings plans. This amendment applies to payments made after 1997.

Clause 44

Instalment Payments

ITA
156.1(1)

Subsection 156.1(1) of the Act sets out definitions that are relevant for the purpose of determining whether relief from tax instalments is available under subsection 156.1(2) or (4) of the Act. The definition "net tax owing" is amended so that tax payable under new Part X.5 of the Act is treated the same as tax under Part I of the Act for this purpose. This amendment applies to 1998 and subsequent taxation years.

Clause 45

Penalties

ITA
163(2)(*c*.2)

Subsections 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 or omission in a return, form, certificate, statement or answer. The amendment to paragraph 163(2)(*c*.2) is consequential on the introduction of the refundable medical expense supplement. It also deletes references to section 126.1 of the Act, which have become obsolete.

This amendment applies to 1997 and subsequent taxation years.

Clause 46

Appeals

ITA
172(3)

Subsection 172(3) of the Act provides a taxpayer with a right of appeal to the Federal Court of Appeal where the Minister of National Revenue takes a number of actions, including refusing to accept an education savings plan for registration under section 146.1 or revoking the registration of such a plan under subsection 146.1(13). The time limit for instituting the appeal is set out in subsection 180(1) of the Act.

Subsection 172(3) is amended so that the right of appeal in respect of a revocation arises because of the sending of a notice of intent to revoke under new subsection 146.1(12.1), rather than because of the revocation itself.

This amendment applies after 1997.

Clause 47

Appeal Period

ITA
180(1)

Subsection 180(1) of the Act sets out the deadline for instituting an appeal to the Federal Court of Appeal after the Minister of National Revenue has taken an action that gives rise to a right of appeal under subsection 172(3). The deadline is 30 days after the date of such action, with provision for the extension of the deadline by the Court.

Subsection 180(1) is amended so that the same deadline also applies with respect to the right of appeal arising from a notice of intent to revoke the registration of a registered education savings plan.

This amendment applies after 1997.

Clause 48

Part VI Tax on Capital of Financial Institutions

ITA
190.1

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

ITA
190.1(1.2)

Subsection 190.1(1.2) of the Act imposes an additional temporary Part VI tax on the taxable capital employed in Canada of financial institutions, other than life insurance corporations. The additional tax is equal to 0.15 per cent of the corporation's taxable capital employed in Canada in excess of its "enhanced capital deduction" of $400 million. Where the corporation is related to another financial

institution at the end of the year, the enhanced capital deduction must be shared by members of the related group.

The additional tax, which was introduced in the 1995 budget and extended in the 1996 budget, is scheduled to expire on October 31, 1997. This amendment extends the application of the additional tax until October 31, 1998. For taxation years that include October 31, 1998, the additional tax will be prorated on the basis of the number of days in the taxation year that are before November 1, 1998.

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

Clause 49

Cumulative Excess Amount in respect of RRSPs

ITA
204.2(1.1)(*b*)

Subsection 204.1(2.1) of the Act imposes a penalty tax in respect of excess contributions made after 1990 to registered retirement savings plans (RRSPs). The amount of tax payable in respect of any month is 1 per cent of an individual's cumulative excess amount at the end of that month.

Subsection 204.2(1.1) of the Act defines an individual's cumulative excess amount at the end of any month in a year to be the excess of the individual's undeducted RRSP premiums at that time over the amount determined by the formula in paragraph 204.2(1.1)(*b*). Generally, the amount determined by the formula is the amount of RRSP deduction room available to the individual for the year *plus* a margin of $2,000.

The formula in paragraph 204.2(1.1)(*b*) is amended, for the 1998 and subsequent taxation years, to add an amount (variable R) which is the individual's total pension adjustment reversal for the year. (See the commentary on the amendments to the definition "RRSP deduction limit" in subsection 146(1) of the Act for further information.)

Clause 50

Labour-Sponsored Venture Capital Corporations

ITA
204.8 to 204.87

Part X.3 of the Act imposes various taxes and penalties on labour-sponsored venture capital corporations (LSVCCs) registered under that Part. A tax credit is provided under section 127.4 of the Act in respect of the acquisition of shares issued by LSVCCs.

Part X.3 is retitled so that it now refers to all LSVCCs, rather than simply those registered under Part X.3. This change is made because of the introduction of new subsections 204.82(5), 204.83(2) and 204.85(2), which apply to LSVCCs not registered under Part X.3.

This amendment applies after February 18, 1997.

Clause 51

Labour-Sponsored Venture Capital Corporations – Definitions

ITA
204.8

"eligible investment"

Section 204.8 of the Act defines terms for the purposes of Part X.3 of the Act.

An "eligible investment" of an LSVCC generally includes a share or debt issued by an eligible business entity where, immediately after the issue of the share or debt, the following three conditions are satisfied:

- the LSVCC's total investment in the eligible entity (and all corporations related to the entity) is not more than 10 per cent of the LSVCC's shareholders' equity and not more than $10 million;

- the carrying value of the total assets of the eligible entity and all corporations related to it does not exceed $50 million; and

- the number of employees of the eligible entity and all corporations related to it does not exceed 500.

The definition is amended so that the $10 million limit is increased to $15 million.

The definition is also amended so that the last two conditions are applied immediately before the issue of the share or debt by the eligible entity, rather than immediately after.

The definition is also amended so that a prescribed LSVCC that is related to the eligible entity is ignored for the purpose of the second condition. It is intended that section 6701 of the *Income Tax Regulations* will be amended to add a cross reference to the definition.

The definition is also amended so that only one-half of the number of employees normally working less than 20 hours per week is taken into account for the purpose of determining whether the 500 employee limit is satisfied.

These amendments apply to property acquired after February 18, 1997.

Clause 52

Labour-Sponsored Venture Capital Corporations – Conditions

ITA
204.81(1)(*c*)(ii)(C)

Subsection 204.81(1) of the Act permits Revenue Canada to register a corporation as an LSVCC under Part X.3 of the Act if its articles satisfy specified conditions and other requirements are met. Clause 204.81(1)(*c*)(ii)(C) sets out the conditions that must be met for an LSVCC to issue additional classes of shares, apart from class A shares issued to individuals and class B shares issued to a labour body. Under this clause, an LSVCC may generally issue only additional classes of shares without voting rights and only if the Minister of Finance approves the shares.

Clause 204.81(1)(*c*)(ii)(C) is amended so that voting rights may be attached to additional classes of shares that can be issued by an LSVCC.

This amendment applies after 1996.

Clause 53

Labour-Sponsored Venture Capital Corporations – Recovery of Credit

ITA
204.82(2) to (2.2)

Subsection 204.82(2) of the Act imposes a tax on an LSVCC that was registered under Part X.3 where, at any time after the fifth taxation year of the LSVCC ending after it first issues Class A shares, it fails to meet a required level of eligible investment. This level, at any time in a particular taxation year, is 60 per cent of the lesser of the LSVCC's shareholders' equity at the end of the preceding taxation year and the LSVCC's shareholders' equity determined at the end of the LSVCC's current taxation year (in both cases determined without taking into account any unrealized gains or losses on the LSVCC's eligible investments). If there is an investment shortfall at any time in the month, the LSVCC is required to pay a tax in respect of the month equal to the greatest such shortfall in the month multiplied by 1/60 of the prescribed rate of interest in effect for the month. Investment shortfalls in 12 consecutive months result in larger taxes and penalties (representing a recovery of federal LSVCC tax credits) applying under subsections 204.82(3) and (4) of the Act.

Subsection 204.82 is amended so that the required investment level at any time in a taxation year is no more than 60 per cent of the amount of the shareholders' equity of the LSVCC 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 LSVCC. This amendment applies to taxation years ending after 1994 and before March 1, 1997.

Subsection 204.82(2) is also being split into three subsections (subsections 204.82(2) to (2.2)), in order to reflect a number of policy changes. The liability for tax is established under subsection 204.82(2). The investment shortfall on which the tax is based is now calculated under subsections 204.82(2.1) and (2.2). In addition, there are five substantive changes being made to the rules that are currently contained in subsection 204.82(2).

The first and second changes are of a technical nature. Amended subsection 204.82(2) makes it clear that the tax under that subsection for a taxation year applies only in respect of months that end in the year. In addition, the investment shortfall for a month that straddles a taxation year is determined with reference to the greatest investment shortfall in the portion of the month that is in the year.

The third change is meant to accommodate LSVCCs that increase their level of small business investment during a taxation year, effectively imposing the required investment level on a more gradual basis. To the extent that an LSVCC's total average cost of eligible investments in a taxation year exceeds the LSVCC's total cost of eligible investments at the time the investment shortfall is being calculated, under new paragraph (*b*) of the description of variable B in subsection 204.82(2.1), the excess will reduce the LSVCC's shortfall at that time. The average total cost for a taxation year is determined solely with reference to costs at the beginning and at the end of the year. This amendment applies to taxation years that end after 1998.

The fourth change is of a tightening nature and is intended to ensure that the minimum general holding period for Class A shares corresponds with the length of time during which the capital raised by such shares is required to be used to acquire eligible investments. Under subsection 211.8(1) of the Act, the general holding period is effectively 8 years for shares acquired after March 5, 1996 and 5 years for shares acquired on or before that date. The change is reflected in paragraphs 204.82(2.2)(*b*) and (*c*), which are rules that apply for the purpose of computing an LSVCC's investment shortfall.

Under these paragraphs, an LSVCC's shareholders' equity at the end of a taxation year must now generally be determined without reference to redemptions of Class A shares that are expected to occur after the end of the year. However, there is an exception for each

redemption that occurs in the first 60 days of the following year, provided that tax under Part XII.5 of the Act became payable as a consequence of the redemption (or the redemption would have been exempt from Part XII.5 tax if it had occurred at the end of the earlier year.) These paragraphs apply for the purpose of computing investment shortfalls in taxation years that end after 1998, except that the percentage of expected redemptions that is ignored is 20 per cent for the 1999 taxation year, 40 per cent for the 2000 taxation year, 60 per cent for the 2001 taxation year and 80 per cent for the 2002 taxation year. This transitional rule allows LSVCCs time to make any necessary increases in their levels of eligible investments.

The last change is meant to encourage investments in smaller businesses, which for this purpose are defined as businesses which do not exceed a $10 million asset limit (rather than the $50 million limit otherwise applicable under the definition "eligible investment" in section 204.8). Under new paragraph 204.82(2.2)(*d*), the cost of each eligible investment in such a business is grossed-up by 50 per cent for the purpose of calculating an LSVCC's investment shortfall at any time, provided the investment was made after February 18, 1997.

Except as noted above, these amendments apply to taxation years that end after February 1997.

ITA
204.82(5)

Subsection 204.82(5) of the Act imposes a new tax under Part X.3 of the Act on LSVCCs that have been prescribed under the *Income Tax Regulations* for the purpose of the definition "approved share" in subsection 127.4(1) and that were not registered under Part X.3.

If such an LSVCC is liable to pay an amount to the government of a province as a consequence of a failure to acquire sufficient properties (i.e., small business properties) of a character described in the law of the province, the LSVCC is generally liable to pay a tax under Part X.3 for the taxation year in which that amount became payable equal to that amount. However, this new subsection does not require the matching of provincially-imposed interest on unpaid provincial amounts payable. Instead, because of section 204.87, interest on unpaid Part X.3 tax will be calculated in accordance with rules under Part I of the Act.

Subsection 204.82(5) also does not apply to any amount payable under or as a consequence of a prescribed provision of the law of the province. It is intended that Part LXVII of the Regulations will be amended to provide a list of prescribed provisions for this purpose. Section 25.1 of the Ontario Labour-Sponsored Venture Capital Corporations Act, which imposes special additional penalties on provincially-registered LSVCCs for the failure to meet provincial investment requirements in respect of certain small businesses, will be included in this list. At this time, no other prescribed provision is contemplated.

In accordance with new subsection 204.86(2), such an LSVCC must file a return under Part X.3 for the taxation year in which tax becomes payable under subsection 204.82(5). The tax is payable within 90 days after the end of the taxation year in which the liability arose.

This amendment applies to liabilities arising after February 18, 1997.

Clause 54

Labour-Sponsored Venture Capital Corporations – Refund of Tax and Penalty

ITA
204.83

Section 204.83 of the Act provides that Revenue Canada must refund 100 per cent of the tax payable by an LSVCC under subsection 204.82(3) and 80 per cent of the penalty payable by it under subsection 204.82(4) where, throughout any 12 month period beginning after the 12 month period in respect of which the tax became payable, it has maintained the required level of eligible investments.

Existing section 204.83 is renumbered as subsection 204.83(1), as a consequence of the introduction of new subsection 204.83(2).

Subsection 204.83(2) is introduced to provide a further refund mechanism, as a consequence of the introduction of subsection 204.82(5) which imposes Part X.3 tax on certain

provincially-registered LSVCCs. The refund is available to such an LSVCC where:

- the government of a province refunds, at any time, an amount to the LSVCC;

- the refund is of an amount that had been paid in satisfaction of a particular amount payable in a taxation year of the LSVCC; and

- tax was payable under subsection 204.82(5) by the LSVCC for a taxation year because the particular amount became payable.

In these circumstances, the LSVCC is, at that time, deemed to have paid an amount on account of its Part X.3 tax payable for that year equal to the amount of the refund.

This amendment applies after February 18, 1997.

Clause 55

Labour-Sponsored Venture Capital Corporations – Restrictions on Dissolution

ITA
204.85

Section 204.85 of the Act provides that a federally-registered LSVCC (including a revoked corporation) may not liquidate or dissolve without the written permission of the Minister of Finance, if the federally-registered LSVCC has issued Class A shares. The Minister of Finance also has the authority to impose terms and conditions upon dissolution of such corporations.

Existing section 204.85 is renumbered as subsection 204.85(1), as a consequence of the introduction of subsection 204.85(2).
Section 204.85 is also amended to provide that, after July 31, 1997, a federally-registered LSVCC may not be amalgamated or merged with another corporation without the written permission of the Minister of Finance.

New subsection 204.85(2) imposes a tax on LSVCCs that have been prescribed for the purpose of the definition "approved share" in subsection 127.4(1) but which are not federally-registered LSVCCs.

This tax is imposed where an amount is payable after February 18, 1997 to the government of a province by an LSVCC as a consequence of the amalgamation or merger of the LSVCC with another corporation, the winding-up or dissolution of the LSVCC or the LSVCC ceasing to be registered under the law of the province. The LSVCC is generally liable to pay a tax under Part X.3 of the Act for the taxation year in which the amount became payable to the province equal to that amount. However, this measure does not require the matching of provincially-imposed interest on unpaid provincial amounts payable. Instead, because of section 204.87, interest on unpaid Part X.3 tax will be calculated in accordance with rules under Part I of the Act. In addition, this measure does not apply to any amount payable under or as a consequence of any provision of the law of the province that is prescribed under Part LXVII of the *Income Tax Regulations*. At this time, no prescribed provision is contemplated.

In accordance with new subsection 204.86(2), an LSVCC must file a return under Part X.3 for the taxation year in which tax becomes payable under subsection 204.85(2). The tax is payable within 90 days after the end of the taxation year in which the liability arose.

Clause 56

Labour-Sponsored Venture Capital Corporations – Return and Payment of Tax

ITA
204.86

Section 204.86 of the Act provides that every federally-registered LSVCC (including revoked corporations) must file an annual return under Part X.3 of the Act.

Existing section 204.86 is renumbered as subsection 204.86(1), as a consequence of the introduction of new subsection 204.86(2).

The effect of new subsection 204.86(2) is described in the commentary on new subsections 204.82(5) and 204.85(2) of the Act.

These amendments apply to taxation years that end after February 18, 1997.

Clause 57

Tax in Respect of Overpayment to Registered Education Savings Plans

ITA
Part X.4
204.9

Part X.4 of the Act provides for a special tax to be paid by subscribers with respect to overcontributions made to registered education savings plans (RESPs).

Part X.4 is amended to reflect the increase in the annual contribution limit in respect of RESP beneficiaries for 1997 and subsequent years. It is also amended to allow the replacement after 1996 of a beneficiary under an RESP by a brother or sister of the beneficiary who is under 21 years of age, generally without penalty tax implications. Part X.4 is also amended to allow Revenue Canada to waive Part X.4 tax where appropriate. Finally, a number of technical changes have been made to improve the operation of this tax.

It should also be noted that, under new subsections 146.1(12.1) to (13), Revenue Canada may revoke the registration of an RESP where a subscriber under the plan is liable for Part X.4 tax because of overcontributions under the plan. However, it is expected that Revenue Canada would generally revoke the registration of a plan on this basis only where there has been a flagrant disregard of the contribution limits.

The following commentary explains the amendments to Part X.4 in greater detail.

Subclause 57(1)

ITA
204.9(1)

Definitions

Subsection 204.9(1) defines a number of expressions used in Part X.4.

An "excess amount" for a year in respect of a beneficiary under an RESP is the total amount on which tax is payable under Part X.4. An excess amount arises when the total of all contributions made into RESPs for a particular beneficiary either exceeds the annual limit of $2,000 in any year, or causes the lifetime contribution limit of $42,000 to be exceeded.

The definition "excess amount" is amended, for 1997 and subsequent years, to raise the $2,000 annual limit to the "RESP annual limit". As defined in subsection 146.1(1) of the Act, the RESP annual limit for 1997 and subsequent years is $4,000. The definition is further amended to refer to the new expression "RESP lifetime limit", rather than $42,000.

The definition "RESP lifetime limit" is introduced to simplify the description of "excess amount". The lifetime limit is $31,500 for 1990 to 1995, and $42,000 for 1996 and subsequent years.

The definition "subscriber's gross cumulative excess" is introduced for the purpose of determining a subscriber's liability for Part X.4 tax. A "subscriber's gross cumulative excess" is the total of all amounts each of which is the "subscriber's share of the excess amount" for a particular year in respect of a beneficiary. The "subscriber's share of the excess amount" is essentially the subscriber's pro-rata share of any RESP overcontributions made in respect of a particular beneficiary. The new definition, which applies for determining Part X.4 tax for months after 1996, is added for technical clarity and does not reflect any change of policy to Part X.4.

Subclause 57(2)

ITA
204.9(4) and (5)

Designation of New Beneficiaries

Paragraph 204.9(4)(*a*) of the existing Act contains an anti-avoidance rule that applies when a beneficiary under an RESP is replaced by another. The rule provides that the contributions previously made into the plan for the former beneficiary are considered to have been made for the new beneficiary. This is intended to ensure that the contribution limits are not multiplied by having a number of plans for different beneficiaries and changing the beneficiary designation just prior to terminating the plans. This existing rule, subject to the amendment described below and changes made for technical clarity, has been maintained under amended subsection 204.9(4).

Amended subsection 204.9(4) also, after 1996, allows an individual under 21 years of age to replace a brother or sister as a beneficiary under an RESP, without penalty tax implications. The contributions that were previously made in respect of the former beneficiary are not taken into account in determining RESP overcontributions or unused limits with regard to the new beneficiary.

To ensure that amended subsection 204.9(4) does not result in excessive penalty tax, new paragraph 204.9(4)(*c*) deems the contributions that were made in respect of the former beneficiary to have been withdrawn at the time of the replacement. Therefore, to the extent that overcontributions were previously made in respect of the former beneficiary, the overcontributions are only taken into account in computing Part X.4 tax in respect of the new beneficiary.

These amendments apply to replacements of beneficiaries that occur after 1996.

Transfers between RESPs

The existing rules with respect to RESP transfers in paragraph 146.1(6.1)(*a*) and 204.9(4)(*b*) have been replaced by new subsection 204.9(5).

Subsection 204.9(5) continues, in modified form, the mechanism for allowing property to be transferred from one RESP to another. Where there has been such a transfer, under paragraph 204.9(5)(*a*) the amount transferred is deemed not to have been contributed into the transferee plan except as provided by paragraph 204.9(5)(*b*) and (*c*).

Paragraph 204.9(5)(*c*) ensures that, in most situations, a transfer from one RESP to another will not have any adverse tax consequences. Transfers after 1996 can be made without resulting in any penalty tax under Part X.4 in two cases:

- there is a common beneficiary under the transferor plan and the transferee plan; or

- a beneficiary under the transferor plan is a sibling of a beneficiary under the transferee plan, provided that the beneficiary under the transferee plan is under 21 years of age.

Except for the two cases described above, transfers can result in penalty tax because of the anti-avoidance rule in paragraph 204.9(5)(*b*). This rule, which is similar to the rule in paragraph 204.9(4)(*a*), is intended to ensure that RESP transfers are not used as a means of multiplying a beneficiary's contribution limits. It provides that the contributions that were previously made by a subscriber into the transferor plan are deemed to have been made by the subscriber in respect of each of the beneficiaries under the transferee plan at the time those earlier contributions were made. In other words, the contribution history in respect of each beneficiary under the transferor plan is, in effect, assumed by each beneficiary under the transferee plan.

In the two cases described above, paragraph 204.9(5)(*d*) provides that the amount transferred is deemed not to have been withdrawn from the transferor plan. This rule is intended to ensure that a distribution from an RESP by way of transfer to another RESP does not in itself reduce Part X.4 tax.

In addition, paragraph 204.9(5)(*e*) provides that each subscriber under the transferor plan is deemed to be a subscriber under the transferee plan. This rule is intended to prevent a subscriber from transferring overcontributions to an RESP that has a different subscriber as a means of circumventing Part X.4 tax. It ensures that the subscriber

under the transferor plan remains liable for any Part X.4 tax resulting from the overcontributions.

New subsection 204.9(5) applies to transfers that occur after 1996.

Clause 58

Tax Payable by Subscribers

ITA
204.91

Calculation of Part X.4 Tax

Under the existing rules in section 204.91 of the Act, the penalty tax is equal to 1 per cent per month on the subscriber's share of the excess amount in respect of a beneficiary to the extent that the share has not been withdrawn.

The method for determining the amount of tax payable in respect of RESP overcontributions is being modified for technical clarity. Under new subsection 204.91(1), the tax is equal to 1 per cent of the amount by which the total of all of the subscriber's gross cumulative excesses (determined at the end of the month) in respect of beneficiaries exceeds the total of such excesses that have been withdrawn from RESPs.

New subsection 204.91(1) applies in computing tax under Part X.4 for months after 1996.

Special Rules

New subsection 204.91(2) of the Act allows Revenue Canada to waive Part X.4 tax where it is just and equitable to do so, having regard to all factors (including a number of factors specifically mentioned in the subsection). This amendment applies from the time of the introduction of Part X.4 (after January 1990).

New subsection 204.91(3) applies where a spouse or former spouse of a subscriber under an RESP has, because of a division of property on marriage breakdown, acquired the subscriber's rights under the plan.

In such a case, for the purpose of determining Part X.4 tax for months after 1997 that are after the acquisition of such rights, all previous contributions made into the plan by the former subscriber are deemed to have been made by the subscriber's spouse or former spouse. The purpose of this rule is to ensure that the spouse who has control over the operation of an RESP is liable for Part X.4 tax in respect of the RESP arising after marriage breakdown.

New subsection 204.91(4) ensures that, after the death of a subscriber of an RESP, the estate of the subscriber becomes liable for any Part X.4 tax in respect of the RESP for months after the death. New subsection 204.91(4) applies for the purpose of determining Part X.4 tax for months after 1997.

Clause 59

Special Tax on Income Payments from Registered Education Savings Plans

ITA
Part X.5
204.94

New Part X.5 of the Act sets out a special 20-per-cent tax on "accumulated income payments" from RESPs. This tax can generally be reduced to the extent that the recipient of such a payment makes deductible RRSP contributions under subsection 146(5) or (5.1) of the Act for the year in which the payment is made. The purpose of this tax is to discourage the use of RESPs strictly for their tax deferral advantages, particularly in regard to individuals who already maximize the tax advantages for retirement savings that are associated with RRSPs.

Subsection 204.94(1) of the Act provides that the meanings given to terms in subsection 146.1(1) also apply for the purposes of new Part X.5. The key definition is "accumulated income payment", which is essentially any distribution from an RESP that is not an educational assistance payment or a refund of payments. The definition "subscriber", which is modified for the purposes of Part X.5 to exclude persons who are subscribers by virtue of

paragraph (*c*) of that definition, is also relevant. For further details on the definitions, see the commentary on amended section 146.1.

The base on which the 20-per-cent Part X.5 tax is charged for a person under subsection 204.94(2) is the sum of two amounts (designated as variables A and B), minus a third amount (designated as variable C).

Variable A is the total of all accumulated income payments made from an RESP under which the person is a subscriber (or, where there is no subscriber, a surviving spouse of a deceased subscriber), to the extent that the payments are included in computing the person's income for the year. For this purpose, subsection 204.94(1) provides that a "subscriber" does not include a person who becomes a subscriber under the plan after the death of a subscriber.

Variable B is the total of all accumulated income payments made from an RESP or a revoked plan, to the extent that the payments are included in computing the person's income for the year and are not included in the value of A.

Variable C is an offset. The maximum offset is equal to the lesser of the value of A and the amounts deducted under subsections 146(5) and (5.1) in computing the taxpayer's income for the year. In addition, there is a $40,000 lifetime limit on the RRSP deductions that can be used to reduce the Part X.5 tax.

The effect of the formula is that only those individuals who received accumulated income payments that are included in the value of A can transfer the payments to an RRSP to minimize Part X.5 tax. This means that the RRSP transfer option is available only to:

- an original subscriber under the plan;

- a subscriber under the plan who is a spouse or former spouse of a former subscriber under the plan and who acquired the former subscriber's rights as a consequence of marriage breakdown; and

- a spouse or former spouse of a deceased subscriber, but only where there is no subscriber under the plan.

The example below illustrates the computation of Part X.5 tax.

EXAMPLE

The RESP under which Marie is an original subscriber permits accumulated income payments. Marie receives $14,000 of such payments in January 1999, of which $5,000 is directly transferred to an RRSP under which Marie is the annuitant. Marie claims a $4,000 RRSP deduction under subsection 146(5) for the 1998 taxation year and a $1,000 deduction for the 1999 taxation year.

Results:

1. *The value of A is $14,000. The value of C is $1,000 (i.e., the $4,000 deduction claimed for 1998 is irrelevant).*

2. *Consequently, the tax under Part X.5 is $2,600 (20% x (14,000 - 1,000)).*

3. *In order to have reduced Part X.5 tax further, Marie should have refrained from deducting RRSP contributions for the 1998 taxation year.*

Subsection 204.94(3) provides that a person liable for Part X.5 tax must file a return on or before the person's tax return filing-due date for the year. Unpaid Part X.5 tax for a year must be remitted to Revenue Canada by that date. Under subsection 204.94(4), administrative rules in Part I of the Act also apply for the purposes of Part X.5.

These amendments apply to 1998 and subsequent taxation years.

Clauses 60 and 61

Tax on Qualifying Environmental Trusts

ITA
Part XII.4
211.6

Part XII.4 of the Act imposes a special tax on mining reclamation trusts, as defined under subsection 248(1).

Part XII.4 is amended so that each reference to a "mining reclamation trust" is replaced by a broader reference to a "qualifying environmental trust". This amendment is in consequence of the extension of the rules for mining reclamation trusts reflected by the new definition "qualifying environmental trust" in subsection 248(1). For more details, see the commentary on that definition.

Part XII.4 is also amended so that the deadlines referred to in subsection 211.6(3) and (4) of the Act for filing the Part XII.4 tax return for a taxation year and paying Part XII.4 tax for the year are now referred to as the trust's "filing-due date" and "balance-due day" for the year, respectively. (Each such deadline for a taxation year is 90 days after the end of the year.) This amendment does not reflect any change in policy.

These amendments apply to the 1997 and subsequent taxation years.

Clause 62

Non-Resident Withholding Tax

ITA
212(1)(*r*)

Paragraph 212(1)(*r*) of the Act provides for non-resident withholding tax under Part XIII of the Act with respect to payments received from registered education savings plan, to the extent that those payments are required to be included in computing income under section 146.1 of the Act.

Paragraph 212(1)(*r*) is amended to ensure that amounts included in computing the non-resident person's taxable income or taxable income earned in Canada are not subject to Part XIII withholding tax.

This amendment applies to amounts paid or credited after February 28, 1979.

Clause 63

Non-Residents – Deemed Payments

ITA
214(3)(*j*)

Under subsection 214(3) of the Act, certain amounts that would, if a non-resident person were resident in Canada, be required to be included in the person's income are treated, for the purpose of the non-resident withholding tax, as payments to the person. Paragraph 214(3)(*j*) applies with respect to amounts that are required to be included in computing income of a subscriber under a registered education savings plan by virtue of subsection 146.1(14).

Paragraph 214(3)(*j*) is being repealed, effective after 1997, consequential on the repeal of subsection 146.1(14).

Clause 64

CPP/QPP Lump Sum Payments

ITA
217(3)(*b*)(ii)

Part XIII of the Act imposes a 25-per-cent tax on certain Canadian-source amounts paid to a person not resident in Canada, including payments from pension and other deferred income plans. Section 217 provides an election whereby such payments are not taxed at the 25-per-cent rate under Part XIII but rather at the ordinary rates under Part I of the Act. This amendment provides that, in computing a person's income for the purpose of this election, the full amount of any CPP/QPP lump sum payment is to be included, i.e., that the special exclusion and tax calculation provided for such payments received by Canadian residents do not apply.

This amendment applies to 1997 and subsequent taxation years.

Clause 65

Taxpayer Information

ITA
241(3.2)

Section 241 of the Act prohibits the communication or use by government officials of information obtained in administering the income tax system, except as authorized by that section. New subsection 241(3.2) permits Revenue Canada to release specified information relating to a charity that was at any time registered under the Act. This information includes the charity's governing documents, the names of its directors and other information relating to the registration of the charity and, if applicable, the revocation of its registration. This information may be released following enactment of this amendment.

Clause 66

Definitions

ITA
248(1)

Subsection 248(1) of the Act defines a number of terms that apply for purposes of the Act.

"cost amount"

Subsection 248(1) of the Act defines "cost amount". The cost amount of an interest of a beneficiary under a mining reclamation trust is considered to be nil.

The definition is amended so that the reference to a "mining reclamation trust" is replaced by a broader reference to a "qualifying environmental trust". This amendment is in consequence of the extension of the rules for mining reclamation trusts reflected by the new definition "qualifying environmental trust" in this subsection. For more details, see the commentary on that definition.

This amendment applies after 1995.

"private foundation"
"public foundation"

The definitions of "private foundation" and "public foundation", which relate to the rules in the Act on charitable organizations, are provided in subsection 149.1(1). Subsection 248(1) is amended to incorporate those definitions for all purposes of the Act. These amendments apply after 1996.

"qualifying environmental trust"
"mining reclamation trust"

Subsection 248(1) of the Act defines the expression "mining reclamation trust". It is generally a trust maintained for the sole purpose of funding the reclamation of a mine in the province in which the trust is resident. The expression is used in paragraphs 12(1)(*z*.1) and (*z*.2), 20(1)(*ss*) and (*tt*) and 75(3)(*c*.1), sections 107.3 and 127.41, Part XII.4 and subsection 250(7), all of which affect the taxation of mining reclamation trusts and their beneficiaries.

The definition "mining reclamation trust" is being repealed, with effect after 1997. All "mining reclamation trusts" will now instead become "qualifying environmental trusts". The existing rules for mining reclamation trusts now apply to qualifying environmental trusts.

The sole purpose of a "qualifying environmental trust" must now be for funding the reclamation of a site in Canada that had been used primarily for, or for any combination of, the operation of a mine, the extraction of clay, peat, sand, shale or aggregates (including dimension stone and gravel) or the deposit of waste. There is no longer any restriction in the definition (as there was under paragraph (*b*) of the definition "mining reclamation trust") that would prevent such funding being used in connection with the reclamation of a clay pit, peat deposit, gravel pit, peat bog, sand pit or stone quarry.

The broader aspects of the definition "qualifying environmental trust" (as compared with the definition "mining reclamation trust") apply to

a trust where the first contribution to the trust was made after 1995, no distributions from the trust were made before February 19, 1997 and no interest in the trust was disposed of before February 19, 1997. However, a trust may elect under paragraph (*i*) of the definition never to have been a "qualifying environmental trust" if, before 1998 or April of the year following the year in which the first contribution to the trust was made, the trust files an election to this effect with Revenue Canada. Such an election also results in a trust losing any status that it might otherwise have as a mining reclamation trust. Revenue Canada has authority to reassess any taxpayer before 2000 in order to give effect to this election.

The introduction of the definition "qualifying environmental trust" applies after 1991, although the broader aspects of the definition will result in a deduction only for taxation years that end after February 18, 1997. For further detail, see the commentary on amended paragraph 20(1)(*ss*) of the Act under which the deduction for contributions to qualifying environmental trusts is provided.

"total pension adjustment reversal"

Subsection 248(1) of the Act is amended to add, after 1996, the definition "total pension adjustment reversal". This expression is defined to have the meaning assigned by regulation. (See the commentary on the amendments to the definition "RRSP deduction limit" in subsection 146(1) of the Act for further information.)

Clause 67

Residence of a Qualifying Environmental Trust

ITA
250(7)

Subsection 250(7) of the Act applies for the purposes of determining the province in which certain trusts reside. It applies where a trust resident in Canada would be a "mining reclamation trust", as defined by subsection 248(1), if it were resident in the province in which the mine to which the trust relates is situated. Where this is the case, the trust is considered to be resident in that province and not in any other province.

Subsection 250(7) is amended so that the reference to a "mining reclamation trust" is replaced by a broader reference to a "qualifying environmental trust". Similarly, reference to a "mine" is replaced by a broader reference to a "site". These amendments are in consequence of the extension of the rules for mining reclamation trusts reflected by the new definition "qualifying environmental trust" in subsection 248(1). For more details, see the commentary on that definition.

This amendment applies after 1995.

DIVISION B

OTHER AMENDMENTS

Clause 68

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 69

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 69(1)

ITA
8(1)(*i*)(vii)

Paragraph 8(1)(*i*) of the Act permits an employee to deduct certain dues and other expenses incurred by the employee in the performance of employment duties. The amendment to this paragraph allows an employee to deduct dues that the employee is required to pay to a professions board, such as *L'Office de professions du Québec*.

This amendment applies to the 1996 and subsequent taxation years.

Subclause 69(2)

Salary Reimbursement

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 69(3)

Reimbursement of Disability Payments

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.

Subclauses 69(4) and (5)

Dues not Deductible

ITA
8(5)

Subsection 8(5) of the Act denies an employee a deduction for annual dues when the dues have been in fact levied for certain purposes. The amendments to this subsection and paragraph 8(5)(*c*) are consequential to the amendment to paragraph 8(1)(*i*) which permits the deduction of dues required to be paid to a professional board. They also ensure the deductibility of such dues paid by an employee where they are not paid to the board itself, but rather to the professional organization of which the employee is a member.

These amendments apply to the 1996 and subsequent taxation years.

Clause 70

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 70(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 70(2)

Methods of Valuation to be the Same

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 70(3)

ITA
10(9) to (11)

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.

New subsection 10(11) deems a corporation's business that is an adventure or concern in the nature of trade to be a business carried on by the taxpayer for the purposes of the "stop-loss" rules in subsections 88(1.1) and 111(5). This will cause losses in this situation to be subject to the usual restrictions in place for the recognition of non-capital losses after an acquisition of control.

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 71

Income from Business or Property – Inclusions

ITA
12

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

Subclause 71(1)

Interest

ITA
12(1)(*c*)

Paragraph 12(1)(*c*) of the Act requires that any interest received or receivable by a taxpayer in a taxation year be included in computing the taxpayer's income for the year. This paragraph is amended as a consequence of the introduction of new subsection 12(4.1) of the Act. New subsection 12(4.1) provides that paragraph 12(1)(*c*) and subsections 12(3) and (4) do not apply to require the inclusion in income of interest on certain impaired loans. New paragraph 12(1)(*c*), which will be subject to subsection 12(3) and new subsection 12(4.1), applies to taxation years that end after September 1997, and also to taxation years that end after 1995 and before October 1997 where the taxpayer elects to have the reserve provisions in new paragraph 20(1)(*l*) of the Act apply to those earlier years.

Subclause 71(2)

Proceeds of Disposition of Right to Receive Production

ITA
12(1)(*g*.1)

Proposed paragraph 12(1)(*g*.1) of the Act requires proceeds of disposition of a right to receive production to which new subsection 18.1(6) of the Act applies to be included in calculating the

income of the vendor. This amendment applies to dispositions that occur after November 17, 1996.

Subclause 71(3)

Inducement, Reimbursement, etc.

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.

Subclause 71(4)

Interest Income

ITA
12(3),(4),(4.1)

Subsection 12(3) of the Act provides that, notwithstanding paragraph 12(1)(*c*) of the Act, corporations, partnerships and certain trusts must use the accrual method for computing interest income in respect of certain debt obligations. This subsection is amended as a consequence of the introduction of proposed new subsection 12(4.1) of the Act. New subsection 12(4.1) provides that paragraph 12(1)(*c*) and subsections 12(3) and (4) do not apply to require the inclusion in income of interest on certain impaired loans. New subsection 12(3), which will be subject to new subsection 12(4.1), applies to taxation years that end after September 1997, and also to taxation years that end after 1995 and before October 1997 where the taxpayer elects to have the reserve provisions in new paragraph 20(1)(*l*) of the Act apply to those earlier years.

Subsection 12(4) of the Act requires that a taxpayer (other than one to which subsection 12(3) applies) who holds an interest in an investment contract on the anniversary day of the contract to include in income for the taxation year that includes that day an amount as interest in respect of the contract. This subsection is amended as a consequence of the introduction of new subsection 12(4.1). Subsection 12(4) will be subject to new subsection 12(4.1). Subsection 12(4.1) provides that paragraph 12(1)(*c*) and subsections 12(3) and (4) do not apply to require the inclusion in income of interest on certain impaired loans. New subsection 12(4) applies to taxation years that end after September 1997, and also to taxation years that end after 1995 and before October 1997 where the taxpayer elects to have the reserve provisions in new paragraph 20(1)(*l*) of the Act apply to those earlier years.

New subsection 12(4.1) of the Act provides that new paragraph 12(1)(*c*) and new subsections 12(3) and (4) of the Act do not apply to a taxpayer in respect of a debt obligation for that portion of a taxpayer's taxation year in which the obligation is impaired and an amount in respect thereof is deductible by the taxpayer under new subparagraph 20(1)(*l*)(ii) of the Act for the year. Interest is therefore not to be included in a taxpayer's income under new paragraph 12(1)(*c*) and new subsections 12(3) and (4) for that portion of the taxation year in which the debt obligation is impaired. This is consistent with the new accounting rules which provide that recognition of interest income in accordance with the terms of the original debt obligation ceases on the impairment of the obligation. New subsection 12(4.1) applies to taxation years that end after September 1997, and also to taxation years that end after 1995 and before October 1997 where the taxpayer elects to have the reserve provisions in new paragraph 20(1)(*l*) of the Act apply to those earlier years.

Clause 72

Accrual Taxation of Life Insurance Policies - Riders

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 73

Recaptured Depreciation

ITA
13

Section 13 of the 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 73(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 73(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 73(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 73(4)

Disposition of Building

ITA
13(21.1)

Subsection 13(21.1) of the Act sets out rules that in certain cases adjust the proceeds of disposition of land and a building. The subsection is amended to clarify that it operates before new subsection 13(21.2), which is another rule that may affect a taxpayer's proceeds of disposition of a building. Specifically, in

measuring a taxpayer's proceeds of disposition of a building of a prescribed class in order to decide whether subsection 13(21.1) applies, those proceeds are to be determined without reference to subsection 13(21.2), as well as without reference to 13(21.1) itself. Similarly, subsection 13(21.2) is to be ignored in computing the proceeds of disposition of the building for the purposes of the adjustments in paragraphs 13(21.1)(*a*) and (*b*).

It is important to note that these changes simply establish an ordering as between subsections 13(21.1) and (21.2); they do not bar 13(21.2) from applying at all. If, after subsection 13(21.1) has been applied to a disposition, there would otherwise remain a terminal loss, and the disposition is one to which subsection 13(21.2) applies, that provision may defer the disposing taxpayer's recognition of the remaining loss.

This amendment applies to dispositions after April 26, 1995, with certain exceptions. These exceptions are described in the notes to new subsection 13(21.2).

Losses on Certain Transfers

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 247, and generally exclude transactions in progress before April 27, 1995. Readers may refer to the notes to clause 247 for more detail.

The third exception is that where a property is disposed of after April 26, 1995, and before June 20, 1996 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 73(5)

Acquisition of Control

ITA
13(24) and (25)

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.

ITA
13(25)

Early Change of Control

Where a corporation referred to in subsection 13(24) of the Act was formed shortly before it underwent an acquisition of control, the exception provided in that subsection for transfers among related persons may not apply. Specifically, the acquired property will not be able to meet the test of having been owned by the corporation or by a related person throughout the period that starts immediately before the twelve month period before the acquisition of control and that ends when the corporation acquires the property.

Subsection 13(25) of the Act is a rule that ensures the appropriate result under subsection 13(24) in such a case. Subsection 13(25) treats a newly-formed corporation as having been in existence from the time immediately before the twelve month period to the time immediately after it was formed, and as having been related during that time to the persons to whom it was related from its formation until the acquisition of control.

Subsection 13(25) is amended, as a consequence of the amendment of subsection 13(24), to use the new test of affiliation rather than the test of being related. This amendment applies to acquisitions of control that occur after April 26, 1995.

Subclause 73(6)

ITA
13(27)(*d*)

Subsection 13(27) of the Act, in conjunction with subsections 13(29) to (32) of the Act 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) of the Act, the taxation year in which capital cost allowance may first be claimed.

Paragraph 13(27)(*d*) of the Act 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 74

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 74(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*) of the Act 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) of the Act.

Subclause 74(2)

Deemed Taxable Capital Gain

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*) of the Act as it applies for the purposes of that section, business income of a taxpayer for a year arising under paragraph 14(1)(*a*)(v) of the Act 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*) of the Act 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 74(3)

Exchange of Property

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 74(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*) of the Act 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) of the Act. For additional details see the commentary on

the amendments to subsections 13(4) and (4.1) and 44(1) and (5) of the Act.

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

Subclause 74(5)

Loss on Certain Transfers

ITA
14(12) and (13)

New subsection 14(12) of the Act 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) of the Act 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) of the Act;

- 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*) of the Act 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) of the Act.

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*) of the Act 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*) of the Act 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 247 of this Act and generally exclude transactions in progress before April 27, 1995. Readers may refer to the notes to clause 247 for more detail.

Clause 75

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 75(1)

Shareholder Debt

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*) of the Act 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 75(2)

Where s. 15(2) Not to Apply

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) of the Act. 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) of the Act 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) of the Act, new paragraph 15(2.4)(*a*) of the Act 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*) of the Act (which restate former subparagraphs 15(2)(*a*)(ii) and (iii) of the Act) 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) of the Act, provides an exemption related to motor vehicle acquisition loans.

New paragraph 15(2.4)(*e*) of the Act 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*) of the Act 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) generally apply to loans made or indebtedness arising in the 1990 and subsequent taxation years.

Employee of Partnership

ITA
15(2.7)

New subsection 15(2.7) of the Act treats certain employees of partnerships as specified employees for the purpose of section 15 of the Act. If an individual is an employee of a partnership and is also a specified shareholder of a corporation or a group of corporations that is entitled to a 10-per-cent or greater share of the income or loss of the partnership, the individual is deemed to be a specified employee of the partnership.

New subsections 15(2) to (2.7) of the Act generally apply to loans made or indebtedness arising in the 1990 and subsequent taxation years.

Subclause 75(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 75(4)

Deemed Benefit to Shareholder by Corporation

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) of the Act 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 76 and 77

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) of the Act, 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) of the Act 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 78

Blended Payments

ITA
16

Section 16 of the Act deals with the treatment of blended payments which are partly of a capital nature and partly of an interest nature.

Subclause 78(1)

Indexed Debt Obligations

ITA
16(6)

Subsection 16(6) of the Act sets out the tax treatment of the index adjustment on indexed debt obligations both for the holders and issuers of such obligations. This subsection is amended as a consequence of the introduction of new subsection 16(7) of the Act. New subsection 16(6), which will be subject to new subsection 16(7), applies to taxation years that end after September 1997, and also to taxation years that end after 1995 and before October 1997 where the taxpayer elects to have the reserve provisions in new paragraph 20(1)(*l*) of the Act apply to those years.

Subclause 78(2)

Impaired Indexed Debt Obligations

ITA
16(7)

New subsection 16(7) of the Act provides that paragraph 16(6)(*a*) of the Act does not apply to a taxpayer in respect of an indexed debt obligation for that portion of a taxation year in which the obligation of a taxpayer is impaired if an amount in respect thereof is deductible under subparagraph 20(1)(*l*)(ii) of the Act by the taxpayer for the year. Interest is therefore not to be included in the income of the taxpayer under subsection 16(6) for that portion of the taxation year in which the indexed debt obligation is impaired. This is consistent with the new accounting rules which provide that recognition of interest income in accordance with the terms of the original debt obligation ceases on the impairment of the obligation. New subsection 16(7) applies to taxation years that end after September 1997, and also to taxation years that end after 1995 and before October 1997 where the taxpayer elects to have the reserve provisions in new paragraph 20(1)(*l*) of the Act apply to those years.

Clause 79

Income from Business or Property - 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 79(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) of the Act. 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 79(2)

ITA
18(13) to (16)

Existing subsection 18(13) of the Act 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) of the Act 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) of the Act;

- 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) of the Act 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 247 of this Act, and generally exclude transactions in progress before April 27, 1995. Readers may refer to the notes to clause 247 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 June 20, 1996 other than a disposition that occurs before 1997 to a person or partnership that was obliged on June 20, 1996 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.