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

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Preface

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

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

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Amendments to the Income Tax Act and Related Regulations

Income Tax Act

Clause 2

Amounts to be included as income from office or employment

ITA
6(1)

Section 6 of the *Income Tax Act* (the “Act”) provides for the inclusion in an employee’s income of most employment-related benefits other than those that are specifically excluded.

ITA
6(1)(*a*)

Paragraph 6(1)(*a*) of the Act provides for the inclusion in computing the income of a taxpayer from an office or employment of the value of employment benefits received or enjoyed by the taxpayer in respect of or in the course of employment, subject to a number of specified exceptions in subparagraphs 6(1)(*a*)(i) to (v). The first of these exceptions, subparagraph 6(1)(*a*)(i), describes benefits that are derived from an employer’s contributions to various types of plans for employees.

As a consequence of the introduction of pooled registered pension plans (PRPPs) and income tax rules to accommodate them, subparagraph 6(1)(*a*)(i) is amended to add a reference to an employer’s contributions to a PRPP. Generally, therefore, benefits derived from such contributions are not included in an employee’s income from employment.

For further information regarding PRPPs, please see the commentary on new section 147.5.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

ITA
6(1)(*e.1*)

New paragraph 6(1)(*e.1*) of the Act includes the amount of an employer’s contributions to a group sickness or accident insurance plan in an employee’s income for the year in which the contributions are made, except to the extent that the contributions are in respect of a plan that provides wage-loss replacement benefits paid on a periodic basis (in those cases, paragraph 6(1)(*f*) will apply in respect of benefits received by the employee). For example, this new paragraph would apply to critical illness insurance or dismemberment insurance that provides benefits paid in lump-sum payments.

This amendment applies in respect of employer contributions made after March 28, 2012 to the extent that the contributions relate to coverage after 2012, except that such contributions made after March 28, 2012 and before 2013 are included in the employee’s income for 2013.

Clause 3

Deductions – “excess EPSP amount”

ITA
8(1)(*o.2*)

Section 8 of the Act provides for the deduction of various amounts in computing income from an office or employment.

New paragraph 8(1)(*o.2*) is introduced consequential on the introduction of new section 207.8, which generally imposes a special tax on excessive allocations to specified employees (as defined in subsection 248(1)) under employee profit sharing plans (EPSPs).

Paragraph 8(1)(*o.2*) allows a taxpayer to deduct an amount that is an "excess EPSP amount" (as defined in subsection 207.8(1)) in computing income for a taxation year. In general terms, under subsection 207.8(1), a taxpayer's excess EPSP amount in respect of an employer for a taxation year is the portion of the employer's total contributions to an EPSP that is allocated to the taxpayer for the year and that exceeds 20% of the taxpayer's total other employment income received in the year from the employer. Excess EPSP amounts are subject to a special tax under subsection 207.8(2), which may be waived or cancelled by the Minister in certain circumstances. The deduction under paragraph 8(1)(*o.2*) is not available in respect of any portion of the taxpayer's excess EPSP amount for which the taxpayer's tax for the year under subsection 207.8(2) is waived or cancelled.

For further information, please see the commentary on new section 207.8.

This amendment applies to the 2012 and subsequent taxation years.

Clause 4

Income inclusion

ITA
12(1)(*l.1*)

Budget 2012 announced the extension of the thin capitalization rules in subsection 18(4) of the Act to debts of a partnership of which a corporation resident in Canada is a member. As part of the implementation of this budget measure, new paragraph 12(1)(*l.1*) is introduced to include an amount in computing the income of a corporation in certain circumstances.

The amount included in a partner's income is determined by reference to interest paid or payable by a partnership of which the corporation is a member on the portion of the debts of the partnership that is allocated to the corporation under subsection 18(7) and that exceeds the corporation's permitted debt-to-equity ratio under the thin capitalization rules.

Since partnership income is calculated at the partnership level and allocated to its partners on a net basis (i.e., after any deduction of interest expense), a partnership's interest expense cannot be denied at the partner level. This income inclusion effectively adds back the relevant portion of the interest that is deductible at the partnership level to the partner's income. The net effect is therefore similar to the interest restriction rule in subsection 18(4). For further information, please see the commentary on subsections 18(4) and 18(7).

The amount included in computing a taxpayer's income is the total of all amounts determined on a partnership-by-partnership basis by the formula A x B / C – D.

Variable A is the deductible interest on the taxpayer's share of the outstanding debts of the particular partnership owing to specified non-residents. The taxpayer's share of the debts is determined by reference to its "debt amount" (as defined in paragraph 18(7)(*a*)). Consistent with the look-through approach to partnerships in subsection 18(7), the taxation year of the corporation is the relevant period for determining what interest is included. Interest that is paid by the partnership in the corporation's taxation year or that is payable by the partnership in respect of the corporation's taxation year (depending on the method followed by the corporation in computing its income) is therefore included regardless of the fiscal period of the partnership.

B / C is the fraction, if any, of the taxpayer's debts (including its share of partnership debts) that exceed the allowable debt-to-equity ratio specified in the thin capitalization rules.

Variable D effectively reduces the paragraph 12(1)(*l.1*) income inclusion by the amount of any foreign accrual property income of a controlled foreign affiliate of the taxpayer that is in respect of interest described in A and that is included in the taxpayer's income for the year or a subsequent year or included in computing the income of the partnership. This variable is the corollary in the partnership context of subsection 18(8), which applies in respect of interest paid or payable to a corporation by a controlled foreign affiliate of the corporation. For further information, please see the commentary on subsection 18(8).

This paragraph applies to taxation years that begin after March 28, 2012.

Clause 5

Shareholder debt

ITA
15(2)

Subsection 15(2) of the Act requires that certain shareholder indebtedness be included in the income of the debtor. Where the debtor is a non-resident, subsection 15(2) works in conjunction with subsection 214(3) to deem a dividend that is subject to non-resident withholding tax under Part XIII of the Act.

Subsection 15(2) is amended in two ways. First, the French version is amended to correct an unintended inconsistency in terminology by replacing the expression « contracter une dette » (to incur a debt) with the expression « devient la débitrice » (has become indebted). Subsection 15(2) was amended in 1998 by S.C. 1998, c.19, s.75(1), generally applicable to loans and indebtedness arising in the 1990 and subsequent taxation years. Prior to that amendment, the English and French versions of subsection 15(2) referred to the expression "has become indebted" (devient la débitrice). However, the 1998 amendments incorrectly introduced into the French version of the subsection the expression « contracter une dette » (to incur a debt).

Second, a new exception is created in respect of a "pertinent loan or indebtedness". "Pertinent loan or indebtedness" is defined for this purpose in new subsection 15(2.11), which is discussed below.

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

The second amendment applies to loans received and indebtedness incurred after March 28, 2012.

Pertinent loan or indebtedness

ITA
15(2.11)

New subsection 15(2.11) of the Act defines the term "pertinent loan or indebtedness" for the purposes of the new exception to the application of subsection 15(2). The result of being a pertinent loan or indebtedness is that such debt, instead of potentially being treated as a deemed dividend under the combined operation of subsections 15(2) and 214(3), will be subject to the new interest imputation rule set out in new section 17.1, discussed below. This regime applies to any loan or indebtedness (to which subsection 15(2) would otherwise apply) that becomes owing after March 28, 2012 to a corporation resident in Canada (the "CRIC") by a subject corporation that is either a non-resident corporation that controls the CRIC (the "controller") or a non-resident corporation that does not deal at arm's length with the controller, if the CRIC and any non-resident corporation that controls the CRIC file a joint election in respect of the loan or indebtedness. This regime is also available for amounts owing by a partnership of which a subject corporation is a member, and for amounts owing to a "qualifying Canadian partnership" in respect of a CRIC (as defined in paragraph 15(2.14)(*a*), discussed below), where all the members of the qualifying Canadian partnership and a non-resident corporation that controls the CRIC file a joint election.

The election in respect of an amount owing must be filed before the CRIC's filing-due date for the taxation year in which the amount owing arises, or in the case of a qualifying Canadian partnership, before the CRIC's filing-due date for its taxation year in which the partnership's fiscal period ends, which fiscal period includes the time the amount owing arises. However, this new regime will not be available where subsection 17.1(3) applies, as discussed below.

New subsection 15(2.11) applies to loans received and indebtedness incurred after March 28, 2012. However, a transitional rule provides additional time for filing an election where the election is otherwise due before the day that is 120 days after Royal Assent.

Late-filed elections and penalty

ITA
15(2.12) and (2.13)

New subsection 15(2.12) of the Act provides a three-year window for late-filing the election referred to in paragraph 15(2.11)(*d*) in respect of a pertinent loan or indebtedness. There is no ministerial discretion – the late-filing provision applies automatically, provided the CRIC pays a penalty, as set out in new subsection 15(2.13), equal to $100 for each month, or part thereof, that the filing is late.

New subsections 15(2.12) and (2.13) apply to loans received and indebtedness incurred after March 28, 2012.

Partnerships

ITA
15(2.14)

New subsection 15(2.14) of the Act provides special rules relating to partnerships for the purposes of subsection 15(2.11) and section 17.1. Paragraph 15(2.14)(*a*) defines the term "qualifying Canadian partnership" in respect of a CRIC as a partnership each member of which is the CRIC or another corporation resident in Canada to which the CRIC is related. Paragraph 15(2.14)(*b*) provides a "look-through" rule to deal with situations where one partnership (an upper-tier partnership) is a member of another partnership (a lower-tier partnership). In these situations, a member of the upper-tier partnership will also be deemed to be a member of the lower-tier partnership.

New subsection 15(2.14) applies to loans received and indebtedness incurred after March 28, 2012.

Mergers

ITA
15(2.15)

New subsection 15(2.15) of the Act provides continuity rules for the purposes of subsections 15(2.11) to (2.14) where corporations are involved in certain amalgamations and windings-up.

New subsection 15(2.15) applies to amalgamations that occur, and windings-up that begin, after March 28, 2012.

Clause 6

Deemed interest income – sections 15 and 212.3

ITA
17.1(1)

New subsection 17.1(1) of the Act provides the interest deeming rules for the new elective "pertinent loan or indebtedness" (in these notes referred to as "PLOI") regimes in the context of subsection 15(2) and section 212.3. More specifically, subsection 17.1(1) applies to "pertinent loans and indebtedness" as defined either in new subsection 15(2.11) (discussed above) or new subsection 212.3(11) (discussed below). Subsection 17.1(1) generally requires that the interest inclusion for a corporation resident in Canada (the "CRIC") in respect of such loans and indebtedness be at least equal to the amount determined by computing that interest at the rate prescribed under paragraph 4301(*b.1*) of the *Income Tax Regulations* or, where the CRIC (or certain non-arm's length persons or partnerships) has incurred one or more debt obligations in order to fund the loan or indebtedness, the amount of interest payable on that debt obligation (or those debt obligations) if it is greater than the amount determined using the prescribed rate.

The references to "indirectly funded" and to interest payable by persons or partnerships other than the CRIC are intended to deal with situations where, for example, a corporation resident in Canada that does not deal at arm's length with the CRIC borrows money, makes an equity contribution to the CRIC, and the CRIC then makes the loan to the relevant non-resident debtor. In such a case, the imputed interest under subsection 17.1(1) is intended to be based on the interest payable by the other corporation if that actual borrowing cost exceeds the interest determined using the prescribed rate.

Provision is also made for amounts owing to a qualifying Canadian partnership in respect of the CRIC and for amounts owed by a partnership of which a non-resident corporation is a member, in the context of PLOIs referred to in subsection 15(2.11). For PLOIs referred to in subsection 212.3(11), the partnership look-through rule in subsection 212.3(25) applies.

Because of the potential overlap between existing section 17 and new subsection 17.1(1), section 17 does not apply to PLOIs. The prescribed rate for subsection 17.1(1) is not the same as the rate for section 17: the rate for subsection 17.1(1) is 4 percentage points higher and there is no rounding-up convention, as provided for in new paragraph 4301(*b.1*) of the *Income Tax Regulations*.

New subsection 17.1(1) applies to taxation years and fiscal periods that end after March 28, 2012.

Acquisition of control

ITA
17.1(2)

New subsection 17.1(2) of the Act provides 180 days of transitional relief from the application of the interest imputation rules in subsection 17.1(1) where a non-resident acquires control of a CRIC that was not controlled by a non-resident corporation immediately before the acquisition of control.

New subsection 17.1(2) applies to taxation years and fiscal periods that end after March 28, 2012, but additional transitional relief is provided for acquisitions of control that occur before Ocotber 15, 2012.

Tax treaties

ITA
17.1(3)

New subsection 17.1(3) of the Act deems a loan or indebtedness that meets all of the conditions for being a pertinent loan or indebtedness under either subsection 15(2.11) or 212.3(11) to not be a PLOI in certain circumstances. This deeming rule will apply where, as a result of the application of a provision of one of Canada's tax treaties, the amount included in computing the income of the CRIC (or a qualifying Canadian partnership in respect of the CRIC), for any taxation year (or fiscal period), in respect of the loan or indebtedness is less than it would be if no tax treaty applied. If this subsection applies, the loan or indebtedness will be subject to the rules in subsection 15(2) or 212.3(2), as the case may be.

New subsection 17.1(3) applies to taxation years and fiscal periods that end after March 28, 2012.

Clause 7

Prohibited Deduction

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.

Limitations on employer contributions to profit sharing plan

ITA
18(1)(*k*)

Paragraph 18(1)(*k*) of the Act prohibits the deduction of employer contributions to a profit sharing plan other than an employees profit sharing plan, a deferred profit sharing plan or a registered pension plan. Subparagraph 18(1)(*k*)(iii) is amended to add pooled registered pension plans (PRPPs) to the list of plans that are excluded from the application of paragraph 18(1)(*k*).

For further information regarding PRPPs, please see the commentary on new section 147.5, and in particular, the commentary on new subsection 147.5(10). The subsection provides a deduction to an employer for its contributions to a PRPP in respect of its employees (or former employees).

Limitation – deduction of interest by certain corporations

ITA
18(4)

The thin capitalization rules in subsection 18(4) of the Act prevent corporations resident in Canada from deducting interest on debts owing to certain specified non-residents to the extent that the debts exceed the corporation's permitted debt-to-equity ratio.

Budget 2012 announced the following amendments to the thin capitalization rules.

- The permissible debt-to-equity ratio in subparagraph 18(4)(*a*)(ii) is reduced from 2:1 to 1.5:1. The new ratio applies to taxation years that begin after 2012.
- The thin capitalization rules are extended to include debts of partnerships that have Canadian resident corporate partners, either directly or through multiple tiers of partnerships. For further information, please see the commentary on paragraph 12(1)(*l.1*) and subsection 18(7).
- The portion of subsection 18(4) before paragraph 18(4)(*a*) is amended to allow for the introduction of an exception to the thin capitalization rules in subsection 18(8) that applies in respect of interest on loans from controlled foreign affiliates. This amendment applies to taxation years that end after March 28, 2012. For further information, please see the commentary on subsection 18(8).
- Interest that is denied under subsection 18(4) or included in a corporation's income under paragraph 12(1)(*l.1*) will be treated as a dividend and not as interest for the purposes of Part XIII withholding tax. For further information, please see the commentary on new subsection 214(16)).

Example

Canco 1 and Canco 2 are Canadian-resident corporations and are equal partners in a partnership that earns income from a business. Canco 1 is wholly owned by Forco, a non-resident corporation. The Canco 1 shares owned by Forco have paid-up capital of $4,000 but Canco 1 has no other capital for the purposes of the thin capitalization rules. Forco lends $3,000 to the partnership and lends $8,500 directly to Canco 1. Absent the application of the thin capitalization rules, interest on both loans is deductible. Interest on both loans is payable on the 15th of every month.

Canco 1 has a 50% interest in the partnership and will therefore be allocated 50% of the partnership loan ($1,500) for thin capitalization purposes. Canco 1 has capital of $4,000 and is considered to have outstanding debts to a specified non-resident (Forco) of $10,000 ($8,500 debt owed by Canco 1 to Forco (direct debt) plus $1,500 in debt allocated from the partnership (indirect debt)).

With a permitted debt-to-equity ratio of 1.5-to-1, Canco 1 has $4,000 of total excess debt (direct and indirect debts) – that is, ($10,000 – 1.5 x $4,000)/10,000, or 2/5 of $10,000. This 2/5 ratio is applied to interest on the debt owed directly to Forco by Canco 1 as well as the debt allocated from the partnership to determine how *much interest is denied by subsection 18(4), or added back to income under paragraph 12(1)(l.1), respectively. Accordingly, 2/5 of the interest deduction in respect of the $8,500 direct loan from Forco will be denied and an amount equal to 2/5 of the deductible interest expense in respect of the $1,500 debt allocated from the partnership will be required to be included in computing the income of Canco 1 from the partnership's business.*

2/5 of each amount paid as interest by Canco 1 throughout the year on the direct loan from Forco will be deemed to have been paid as dividends by Canco 1 to Forco. This includes any interest that is payable at the end of Canco 1's taxation year. Canco 1 may then designate which payments of interest are to be designated as dividends for thin capitalization purposes.

Similarly, the amount included under paragraph 12(1)(l.1) in computing the income of Canco 1 will be deemed to have been paid as a dividend by Canco 1 to Forco at the end of Canco 1's taxation year.

Contributed surplus

ITA
18(4)(*a*)

An amendment is also made to subsection 18(4) in the context of the foreign affiliate dumping rules. The contributed surplus provision in clause 18(4)(*a*)(ii)(B) is amended in order to exclude any portion of a corporation's contributed surplus that arises in connection with an investment to which new subsection 212.3(2) applies by virtue of subsection 212.3(1). That is, although the consequences under subsection 212.3(2) would not apply to the extent contributed surplus arises, subsection 212.3(2) applies where the conditions in paragraphs 212.3(1)(*a*) to (*c*) are met. For example, as a result of this amendment, a foreign parent that transfers shares of a non-resident subsidiary to its Canadian subsidiary for no consideration would, if the conditions in subsection 212.3(1) are met, be prevented from counting any contributed surplus arising from such a transfer in determining its thin capitalization "room". In effect, for the purposes of the foreign affiliate dumping rules, contributed surplus is put on the same footing as paid-up capital (which is reduced under paragraph 212.3(2)(*b*)), as a result of this amendment to the thin capitalization rules. Similar amendments are also made to subsection 84(1), as discussed below.

Refer to the commentary on section 212.3 for a detailed description of the foreign affiliate dumping rules.

This amendment comes into force on March 29, 2012.

Definitions

ITA
18(5)

Subsection 18(5) of the Act is amended in two ways. The opening words of subsection 18(5) are amended to provide that its definitions apply for the purposes of new subsection 18(7) and the new definition "specified proportion" is added.

"specified proportion"

Subsection 18(5) is amended to add the definition "specified proportion" of a member of a partnership for a fiscal period of the partnership. A partner's specified proportion for the fiscal period is that proportion of the partnership's total income or loss for that period that is the member's share. If the partnership's income or loss for the period is nil, the proportion is computed as if the partnership had $1 million of income for the period. This definition is used to allocate the debts of a partnership to its members for the purposes of the thin capitalization rules. For further information, please see the commentary on paragraph 12(1)(*l.1*), and subsections 18(4) and (7).

These amendments apply to taxation years that begin after March 28, 2012.

Partnership debts

ITA
18(7)

New subsection 18(7) of the Act extends the application of the thin capitalization rules in subsection 18(4) to include a corporation's share of debts of partnerships in which it is a member, either directly or through multiple tiers of partnerships, in determining whether it has exceeded its permitted debt-to-equity threshold.

Subsection 18(7) deems that, for the purposes of paragraph 18(4)(*a*), subsections 18(5) to (6) and paragraph 12(1)(*l.1*),

- each member of a partnership owes that member's share of the debts of the partnership (called the "debt amount");
- the member owes this debt amount to the creditor; and
- the member has paid the interest that is deductible by the partnership with respect to the debt amount.

A partner's share of the debts of a partnership is determined at any time by reference to its "specified proportion", a new definition added in subsection 18(5), in respect of the partnership for the last fiscal period of the partnership ending at or before the partner's taxation year end. Where this is not determinable (e.g., because the first fiscal period of the partnership ends after the partner's year end), the partner's share of the debts of a partnership is determined by reference to the relative fair market value of its interest in the partnership.

Paragraphs 18(7)(*b*) and (*c*) ensure that the allocated debts qualify as "outstanding debts to specified non-residents" as defined in subsection 18(5). Paragraph 18(7)(*b*) ensures that the relationship between the lender and the corporate partner that is potentially subject to the subsection 18(4) interest deduction denial is tested to determine whether the relevant debts are payable to a specified non-resident. Paragraph 18(7)(*c*) ensures that the debt will meet the conditions in subparagraph (*a*)(ii) of the definition of "outstanding debts to specified non-resident" in subsection 18(5) to the extent an amount in respect of the interest is deductible to the partnership.

This subsection applies to taxation years that begin after March 28, 2012.

Exception – foreign accrual property income

ITA
18(8)

Since debts owing by a Canadian corporation to a controlled foreign affiliate of the corporation can qualify as outstanding debts to specified non-residents for the purposes of subsection 18(4) of the Act, interest on such a debt could be both included in the Canadian corporation's income (in respect of foreign accrual property income (FAPI)) under subsection 91(1) and non-deductible because of subsection 18(4).

New subsection 18(8) prevents this form of double taxation by permitting a corporation to deduct interest that would otherwise have been disallowed under the thin capitalization rules to the extent an amount in respect of the interest is included, either in the corporation's taxation year or a subsequent taxation year, in the corporation's income as FAPI.

Example

Canco is a taxable Canadian corporation and a wholly-owned subsidiary of a Canadian public corporation. Canco owns 75% of the only class of shares of Forco, which is a controlled foreign affiliate (as defined in subsection 95(1)) of Canco. Forco lends $1,000 to Canco with an annual interest rate of 5%. Canco has no capital for thin capitalization purposes. Forco has $10 of expenses that may be deducted in computing its FAPI and Canco's participating percentage in respect of Forco is 75% for the purposes of subsection 91(1).

The entire $50 of interest payable in respect of the year would, absent the application of subsection 18(8), therefore be denied by subsection 18(4). However, $30 of the $50 of interest paid by Canco to Forco (75% of its

$40 of FAPI) would be included by subsection 91(1) in computing the income of Canco. The amount of interest denied by subsection 18(4) would therefore be reduced to $20 ($50 denied interest - $30 FAPI).

This subsection applies to taxation years that end after 2004.

Limitations on interest expense

ITA
18(11)(*c*)

Subsection 18(11) of the Act prohibits the deduction of interest expenses in respect of indebtedness incurred for the purposes of making a contribution to a registered retirement savings plan or certain other deferred income plans.

Paragraph 18(11)(*c*) is amended to extend the prohibition on interest deductibility to money borrowed by an individual to make a contribution to a pooled registered pension plan (PRPP) or money borrowed by an employer to make a contribution to a PRPP that is not deductible under paragraph 20(1)(*q*).

For further information, see the related commentary on paragraph 20(1)(*q*) and on new subsection 147.5(10) regarding the deductibility of employer contributions to PRPPs.

These amendments will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 8

Employer contributions to PRPPs

ITA
20(1)(*q*)

Subsection 20(1) of the Act describes certain amounts that may be deducted in computing the income of a taxpayer for a taxation year. Paragraph 20(1)(*q*) permits an employer to deduct contributions made to a registered pension plan.

As a consequence of the introduction of pooled registered pension plans (PRPPs) and the income tax rules to accommodate them, paragraph 20(1)(*q*) is amended to add a reference to employer contributions to a PRPP.

For further information regarding PRPPs, please see the commentary on new section 147.5.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Limitation of expression "life insurance policy"

ITA
20(2.2)(*a*)

Subsection 20(2.2) provides certain exceptions to the definition "life insurance policy" for the purposes of paragraphs 20(1)(*c*) and (*d*). The exceptions effectively permit interest on money borrowed to acquire certain insurance products to qualify for a deduction under those paragraphs.

Paragraph 20(2.2)(*a*) is amended to add a reference to "pooled registered pension plan" (PRPP). Since paragraph 18(11)(*c*) is amended to prohibit the deduction of interest on money borrowed to make a PRPP contribution (other than an employer contribution), this amendment will be effective only to permit a deduction for interest paid on money borrowed to make an employer contribution to a PRPP in respect of a life insurance policy that is issued under a PRPP.

Clause 9

Scientific research and experimental development

ITA
37

Budget 2012 announced a number of changes to the income tax treatment of expenditures incurred by a taxpayer on or in respect of scientific research and experimental development (SR&ED) carried on in Canada. These changes will impact the types of expenditures that are deductible under section 37 of the Act and are eligible for an investment tax credit (ITC) under section 127, (commonly known as SR&ED tax incentives). First, expenditures of a capital nature will no longer qualify for SR&ED tax incentives. Second, the rate at which overhead SR&ED expenditures are accounted for under the so-called proxy method will be gradually reduced from 65 % to 55%. Third, third-party arm's length payments for SR&ED expenditures will only be 80% eligible for ITCs. Fourth, the basic 20% ITC for SR&ED qualified expenditures will be reduced to 15%.

Section 37 provides, among other things, that a taxpayer carrying on business in Canada may deduct certain expenditures of a current nature incurred on SR&ED carried on in Canada. For an expenditure of a capital nature to be so eligible, the expenditure must be "all or substantially all" attributable to the prosecution of SR&ED in Canada. Under subsection 37(1), the expenditures are pooled to be deducted in the year incurred or carried forward indefinitely.

There are a number of ways in which SR&ED may be performed. Taxpayers can perform SR&ED directly, have someone else perform SR&ED on their behalf, or make payments for SR&ED to be carried on by third-parties.

ITA
37(1)

Subsection 37(1) of the Act is amended in three respects.

Subparagraph 37(1)(*a*)(i) describes expenditures of a current nature made by a taxpayer on SR&ED carried on in Canada directly by or on behalf of the taxpayer, and related to the taxpayer's business. Paragraph 37(1)(*a*) is amended by adding new subparagraph (i.01), which describes SR&ED carried out on behalf of the taxpayer. As a consequence, subparagraph 37(1)(*a*)(i) is also amended to remove the reference to SR&ED carried out on behalf of the taxpayer.

The amendments to subparagraph 37(1)(*a*) apply in respect of expenditures made after 2012.

Second, paragraph 37(1)(*b*) describes expenditures of a capital nature directly made by a taxpayer on SR&ED carried on in Canada and related to the taxpayer's business. Paragraph 37(1)(*b*) is repealed. Such capital expenditures will be subject to the treatment otherwise applicable to them under the Act. The amendment to paragraph 37(1)(*b*) applies in respect of expenditures made after 2013 and expenditures that subsection 37(1.2) deems not to have been made before 2014. In general terms, subsection 37(1.2) provides that an expenditure of a capital nature has not been made (i.e., cannot be deducted under section 37) until the property is first available for use.

Third, paragraph 37(1)(*d*) is amended consequential on the repeal of paragraph 37(1)(*b*) to ensure that paragraph 37(1)(*d*) will only apply in respect of expenditures described in paragraph 37(1)(*b*) if the expenditures are made before 2014. The amendment to paragraph 37(1)(*d*) comes into force on January 1, 2014.

ITA
37(6)

Subsection 37(6) treats amounts claimed under subsection 37(1) in respect of expenditures of a capital nature as capital cost allowance allowed to the taxpayer in respect of the property.

Consequential on the repeal of paragraph 37(1)(*b*), subsection 37(6) is amended to ensure that it applies in respect of property described in paragraph 37(1)(*b*) only if the property is acquired before 2014.

The amendment to subsection 37(6) comes into force on January 1, 2014.

ITA
37(6.1)

Subsection 37(6.1), together with paragraph 37(1)(*h*), restricts a corporation's ability to carry forward its pool of unused SR&ED deductions where there has been an acquisition of control of the corporation. In general terms, the undeducted portion of SR&ED expenditures made before control of a corporation is acquired may be carried forward to be deducted in computing its income for a subsequent taxation year if the business to which the expenditures related is carried on after the acquisition of control by the corporation for profit or with a reasonable expectation of profit, and only to the extent of its income for the year (before making any deduction under subsection 37(1)) from that or a similar business.

ITA
37(6.1)(*a*)(i)(B)

Consequential on the repeal of paragraph 37(1)(*b*), clause 37(6.1)(*a*)(i)(B) is amended to ensure that subsection 37(6.1) applies in respect of expenditures and property described in paragraph 37(1)(*b*) only if the expenditures are made, or the property acquired, before 2014.

The amendment to clause 37(6.1)(*a*)(i)(B) comes into force on January 1, 2014.

Interpretation

ITA
37(8)

Subsection 37(8) of the Act provides rules for determining which expenditures incurred in respect of SR&ED are eligible for inclusion in subsection 37(1) in the case of expenditures incurred in Canada and subsection 37(2) in the case of expenditures incurred outside Canada.

ITA
37(8)(*a*)

Subparagraph 37(8)(*a*)(ii) of the Act provides rules for interpreting the expression "expenditures on or in respect of scientific research and experimental development" incurred in Canada.

Subclauses 37(8)(*a*)(ii)(A)(III) and 37(8)(*a*)(ii)(B)(I), (III) and (VI) are repealed consequential on the repeal of paragraph 37(1)(*b*), which implements the Budget 2012 proposal to no longer allow the deduction of expenditures of a capital nature under section 37. In addition, subclause 37(8)(*a*)(ii)(B)(II) is amended to ensure that it applies only to expenditures of a current nature.

These amendments apply in respect of expenditures made after 2013 and expenditures that subsection 37(1.2) deems not to have been made before 2014.

ITA
37(8)(*d*)

Paragraph 37(8)(*d*) of the Act provides, amongst other things, that a capital expenditure made for, or in respect of, a building (other than a prescribed special-purpose building) does not qualify as an expenditure on, or in respect of, SR&ED. Paragraph 37(8)(*d*) is amended consequential on the repeal of paragraph 37(1)(*b*).

Paragraph 37(8)(*d*) is amended to provide that an expenditure of a current nature does not include an expenditure made by a taxpayer for the acquisition of a property from a person or partnership that is a capital property of the taxpayer, or expenditures for the use of, or the right to use, property that would be capital property of the taxpayer if the property were owned by the taxpayer. As a consequence, expenditures incurred by a taxpayer in developing a capital property, e.g., salaries paid to employees to develop a SR&ED property, will generally be considered, for tax purposes, to be expenditures of a current nature.

This amendment applies in respect of expenditures made after 2013 and expenditures that subsection 37(1.2) deems not to have been made before 2014.

Look-through rule

ITA
37(14)

New subsection 37(14) of the Act provides a look-through rule to ensure that expenditures incurred by a taxpayer in respect of SR&ED performed on behalf of the taxpayer or by third-party entities include only expenditures of a current nature. In particular, for the purposes of subparagraphs 37(1)(*a*)(i.01) to (iii), the amount of a particular expenditure made by a taxpayer is to be reduced by the amount of any related expenditure of the person or partnership (the SR&ED performer) to whom the particular expenditure is made that is not an expenditure of a current nature of the person or partnership.

This amendment applies in respect of expenditures made after 2013 and expenditures that subsection 37(1.2) deems not to have been made before 2014.

Reporting of certain payments

ITA
37(15)

New subsection 37(15) of the Act provides that where a taxpayer is required to reduce an expenditure because of the expenditure look-through rule in subsection 37(14), the SR&ED performer (the person or the partnership referred to in subsection 37(14)) is required to inform the taxpayer in writing of the amount of the reduction. This information is to be provided without delay if requested by the taxpayer and in any other case no later than 90 days after the end of the calendar year in which the expenditure was made.

This amendment applies in respect of expenditures made after 2013 and expenditures that subsection 37(1.2) deems not to have been made before 2014.

Clause 10

Amounts to be deducted

ITA
53(2)(*c*)

Paragraph 53(2)(*c*) of the Act provides for deductions to the adjusted cost base of a taxpayer's partnership interest. Subparagraph 53(2)(*c*)(xiii) is introduced consequential on the introduction of the provisions relating to transfer pricing secondary adjustments found in subsections 247(12) to (15). These subsections apply only to corporations and as a result, subparagraph 53(2)(*c*)(xiii) is only relevant for corporate partners. For further information on subsections 247(12) to (15), see the commentary on those subsections.

Subparagraph 53(2)(*c*)(xiii) provides for a reduction in the adjusted cost base of a taxpayer's interest in a partnership equal to the amount by which a deemed dividend under subsection 247(12) in respect of a transaction or series of transactions in which the partnership was a participant, is reduced under subsection 247(13) as the result of a repatriation of funds to the taxpayer. This adjusted cost base reduction results from what is, in effect, a distribution of funds from the partnership to the taxpayer that is made through the repatriation mechanism in subsection 247(13).

This subparagraph comes into force on March 29, 2012.

Clause 11

Amounts included in income

ITA
56(1)(*z.3*)

Subsection 56(1) of the Act describes certain amounts that are required to be included in computing the income of a taxpayer for a taxation year.

New paragraph 56(1)(*z.3*) creates a reference to amounts required to be included in income because of new section 147.5. Section 147.5 provides rules relating to pooled registered pension plans (PRPPs) and, in general terms, amounts distributed from a taxpayer's account under a PRPP are required to be included in computing the taxpayer's income.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 12

Rollover of proceeds on death

ITA
60(*1*)(v)

In circumstances where an individual has received (or is deemed to have received) certain taxable lump-sum amounts from a registered retirement savings plan (RRSP), a registered retirement income fund (RRIF) or a registered pension plan (RPP), paragraph 60(*l*) of the Act allows the individual to claim an offsetting deduction for qualifying payments (not exceeding the amounts so received) made by or on behalf of the individual.

As a consequence of the introduction of pooled registered pension plans (PRPPs) and the income tax rules to accommodate them, several amendments are made to subparagraph 60(*l*)(v) to permit certain qualifying survivors of deceased PRPP members to rollover PRPP proceeds (i.e., transfer on a tax-deferred basis) to the survivor's registered vehicles. That is, to the extent that the taxable PRPP amounts are paid to the survivor taxpayer's RRSP or RRIF, the taxpayer may claim an offsetting deduction under paragraph 60(*l*).

For further information regarding PRPPs, please see the commentary on new section 147.5.

These amendments will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

ITA
60(*l*)(v)(A.1)

New clause 60(*l*)(v)(A.1) is added to the Act consequential on the introduction of new subsection 147.5(17). Subsection 147.5(17) deems amounts paid to a deceased PRPP member's estate to have been paid directly to a "qualifying survivor", if the survivor and the legal representative of the deceased PRPP member's estate so elect. When such an election is made, PRPP death benefits may be included in the qualifying survivor's income instead of being included in the deceased PRPP member's income. If other conditions under paragraph 60(*l*) are satisfied, clause 60(*l*)(v)(A.1) provides an offsetting deduction for any corresponding amount that is used to acquire a qualifying annuity or is paid into an RRSP or RRIF under which the qualifying survivor is an annuitant.

ITA
60(*l*)(v)(B.01)

Clause 60(*l*)(v)(B.01) may apply in circumstances where a taxpayer was financially dependent for support on a parent or grandparent because of the taxpayer's mental or physical infirmity and that parent or grandparent dies. If, as a consequence of the parent's or grandparent's death, the taxpayer receives taxable proceeds from the deceased parent's (or grandparent's) RRSP, RRIF or RPP, a payment made to the taxpayer's RRSP or RRIF (not exceeding the amount received) is eligible for an offsetting deduction. Paragraph 60(*l*) is amended to include amounts received from a PRPP of the deceased parent or grandparent. Specifically, clause 60(*l*)(v)(B.01) is amended so that a lump-sum death benefit received from a "pooled registered pension plan" is included in computing the limit on the deduction for amounts paid to the infirm taxpayer's RRSP or RRIF.

ITA
60(*l*)(v)(B.1)

If, as a consequence of the death of a parent or grandparent on whom a minor was financially dependent, the minor receives taxable proceeds from the deceased parent's (or grandparent's) RRSP, RRIF or RPP, a payment made to acquire an immediate annuity payable for a fixed term not exceeding 18 years minus the age of the minor at the time of acquisition is a qualifying payment for the purposes of paragraph 60(*l*).

Paragraph 60(*l*) is amended to generally permit a financially dependent minor child or grandchild of a deceased pooled registered pension plan member to take a deduction for any taxable amounts received from the PRPP (after the death) used to purchase a term (to age 18) annuity. Specifically subclause 60(*l*)(v)(B.1)(II) is amended so that a lump-sum death benefit received from a "pooled registered pension plan" is included in computing the limit on the deduction for the cost of acquiring the annuity.

Clause 13

Rollover to RDSP – definitions

ITA
60.02(1)

Section 60.02 of the Act provides definitions and rules that apply for the purposes of a tax-deferred rollover to a registered disability savings plan (RDSP) after the death of a registered retirement savings plan (RRSP) or registered retirement income fund (RRIF) annuitant or of a member of a registered pension plan (RPP).

"eligible individual"

An "eligible individual" is a child or grandchild of a deceased RRSP or RRIF annuitant or of a deceased RPP member who was financially dependent on the deceased, at the time of the deceased's death, by reason of mental or physical infirmity of the dependant. The definition "eligible individual" is amended to include an infirm financially-dependent child or grandchild of a deceased member of a pooled registered pension plan (PRPP).

"eligible proceeds"

Eligible proceeds are generally any of a refund of premiums from an RRSP, an eligible amount paid from a RRIF or a lump-sum payment (other than from actuarial surplus) from an RPP, that is received by an eligible individual as a consequence of the death, after March 3, 2010, of a parent or grandparent of the eligible individual. The definition "eligible proceeds" is amended to add a reference to a lump-sum payment from a PRPP received by an eligible individual as a consequence of the death of a parent or grandparent of the eligible individual.

For further information regarding PRPPs, please see the commentary on new section 147.5.

These amendments will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 14

Pension income splitting

ITA
60.03(1)

Section 60.03 of the Act allows a taxpayer to allocate up to 50% of the taxpayer's eligible pension income (as defined in subsection 60.03(1)) to the taxpayer's spouse or common-law partner in certain circumstances. This is often referred to as "pension income splitting". Subsection 60.03(1) provides definitions that apply for the purposes of the pension income splitting rules.

"eligible pension income"

The existing definition "eligible pension income" in subsection 60.03(1) imports the definition of the same term in subsection 118(7), which provides definitions that apply in relation to the pension income credit. The definition in subsection 60.03(1) is amended to also include income received from a retirement compensation arrangement (RCA) in certain circumstances.

In particular, this amendment will enable a couple to include RCA income for pension income splitting purposes if the recipient of the RCA income is at least 65 years old, the RCA provides benefits in the form of life annuity payments that are supplemental to the benefits of a registered pension plan (other than an individual pension plan) and the amount of RCA income to be split does not exceed the amount described in new subparagraph (*b*)(ii) of the definition. The limit in subparagraph (*b*)(ii) is the defined benefit limit (as defined in subsection 8500(1) of the *Income Tax Regulations*) multiplied by 35 minus the recipient's other eligible pension income. The effect will be to enable couples to split qualifying RCA income, but only to the extent that the total amount of eligible pension income they elect to split does not exceed the limit in subparagraph (*b*)(ii) (approximately $93,000 for 2013). The defined benefit limit, times 35 years of service, is equal to the maximum defined benefit pension available under the existing registered pension plan limits for a 35-year career.

This amendment applies to the 2013 and subsequent taxation years.

Clause 15

Exception from attribution rules

ITA
75(3)(*a*)

Subsection 75(3) of the Act exempts a number of trusts from the attribution rule in subsection 75(2), under which any income or loss from trust property held by certain reversionary trusts can be attributed for tax purposes to the persons from whom the property was received. Paragraph 75(3)(*a*) exempts certain trusts governed by plans such as registered pension plans, registered retirement savings plans, and employee benefit plans.

Paragraph 75(3)(*a*) is amended to add trusts governed by pooled registered pension plans (PRPPs) to the list of exempt trusts. For further information regarding PRPPs, please see the commentary on new section 147.5.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 16

Deemed dividend

ITA
84(1)(*c.1*) to (*c.3*)

Subsection 84(1) of the Act deems a dividend to have been paid by a corporation on the shares of a class of its capital stock where the paid-up capital of the class is increased by the corporation in circumstances other than those set out in that subsection. Paragraphs 84(1)(*c.1*) to (*c.3*) provide exceptions where the paid-up capital is increased by way of a conversion of contributed surplus in certain circumstances.

Similar to the amendment to clause 18(4)(*a*)(ii)(B) discussed above, paragraphs 84(1)(*c.1*) to (*c.3*) are amended in order to exclude any portion of contributed surplus that arises in connection with an investment to which the foreign affiliate dumping rules in new subsection 212.3(2) apply by virtue of subsection 212.3(1). Thus, a deemed dividend will now arise to the extent that contributed surplus created in a foreign affiliate dumping transaction is converted into paid-up capital. For further information, see the commentary on clause 18(4)(*a*)(ii)(B).

These amendments come into force on March 29, 2012.

Clause 17

Continuation

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

Paragraph 87(2)(*g.1*) of the Act provides that – for the purposes of section 12.4, the rules relating to the special reserves for banks in section 26, and the rules relating to transitional unpaid claims reserves for insurers in section 12.3 and subsection 20(26) – a new corporation formed as a result of an amalgamation is the same corporation as, and a continuation of, each predecessor corporation.

Paragraph 87(2)(*g.1*) is amended consequential on the introduction of new subsection 97(3) and to reflect the previously proposed repeal of section 12.3 and subsection 20(26). This amendment applies to amalgamations that occur, and windings-up that begin, after March 28, 2012.

Clause 18

Winding-up

ITA
88

Section 88 of the Act deals with the tax consequences arising from the winding-up of a corporation. One of the rules in the section provides that the cost of certain capital assets acquired by a taxable Canadian corporation (the parent) on the winding-up of its 90-percent-owned subsidiary that is also a taxable Canadian corporation can be increased to take into account, subject to certain limits, the amount paid by the parent to acquire the shares of the subsidiary. Properties that could produce income upon a disposition are not eligible for this cost base increase, such as eligible capital property, depreciable property, inventory and resource property (ineligible property). The same rule allowing for a cost base increase also applies on the vertical amalgamation of a parent and its wholly-owned-subsidiary.

Budget 2012 announced a number of changes to prevent structures that have been used in an attempt to, as part of a series of transactions, indirectly increase the cost base of ineligible properties on the winding-up of a subsidiary. Typically, a subsidiary would hold such properties indirectly through a partnership, and the parent corporation would seek to increase the cost base of the partnership interest, even if the fair market value of the interest is attributable to ineligible property. Budget 2012 also announced that related anti-avoidance amendments to the Act would be introduced as necessary to give effect to the budget proposal.

Winding-up

ITA
88(1)

Subsection 88(1) of the Act provides rules that apply if a subsidiary has been wound-up into its parent in circumstances where both the parent and its subsidiary are taxable Canadian corporations and the parent owns at least 90% of the issued shares of each class of the capital stock of the subsidiary.

ITA
88(1)(*d*)(ii.1)

Paragraph 88(1)(*d*) of the Act determines, for the purposes of paragraph 88(1)(*c*), the amount by which the parent may increase or "bump" the adjusted cost base (ACB) of non-depreciable capital property acquired by it on the winding-up of its subsidiary. Subparagraph 88(1)(*d*)(ii) provides that the bump amount (i.e., the increase in ACB) cannot exceed the amount, if any, by which the fair market value of the capital property at the time the parent last acquired control of the subsidiary exceeds the cost amount to the subsidiary of the property immediately before the winding up.

Paragraph 88(1)(*d*) is amended by adding new subparagraph 88(1)(*d*)(ii.1). Subparagraph 88(1)(*d*)(ii.1) reduces the fair market value of an interest in a partnership held by a subsidiary at the time the parent last acquired control of the subsidiary to the amount determined by the formula A – B where

A is the fair market value of the partnership interest at the time the parent last acquired control of the subsidiary (determined without reference to subparagraph 88(1)(*d*)(ii.1)).

B is the portion of the amount by which the fair market value of the interest at the time the parent last acquired control of the subsidiary (determined without reference to subparagraph 88(1)(*d*)(ii.1)) exceeds its cost amount as may reasonably be regarded as being attributable to the total of all amounts each of which is

- in the case of a depreciable property held directly by the partnership or held indirectly by the partnership through one or more other partnerships, the amount by which the fair market value (determined without reference to liabilities) of the depreciable property exceeds its cost amount – that is, the amount that is the fair market value of the interest is reduced by the amount of unrealized recapture income and gains in respect of the partnership's depreciable property when the parent last acquired control of the subsidiary;
- in the case of a Canadian resource property or a foreign resource property held directly by the partnership or held indirectly by the partnership through one or more other partnerships, the fair market value (determined without reference to liabilities) of the property; and
- in the case of a property that is not capital property, a Canadian resource property or a foreign resource property (for example, eligible capital property and inventory of a business) held directly by the partnership or held indirectly by the partnership through one or more other partnerships, the amount by which the fair market value (determined without reference to liabilities) of the property exceeds its cost amount.

Subparagraph 88(1)(*d*)(ii.1) is meant to ensure that the bump available in respect of a subsidiary's interest in a partnership does not reflect unrealized gains and recapture income in respect of property that would not be eligible for a bump if it were held directly by the subsidiary (i.e., ineligible property). The subparagraph achieves this by reducing the fair market value of the partnership interest by the unrealized gains and recapture income in respect of ineligible property that is either held directly by the partnership or held indirectly through one or more other partnerships.

In particular, the subparagraph reduces the fair market value of the subsidiary's interest in a partnership by the portion of its gain in respect of the partnership interest (i.e., the subsidiary's "outside" gain) that "may reasonably be regarded as being attributable" to the total gains in respect of the partnership's ineligible property (i.e., the total "inside" gains). The determination of the portion of a corporate partner's outside gain in respect of a partnership interest that "may reasonably be regarded as being attributable" to the total inside gains in respect of the partnership's ineligible property will depend on the factors present in each particular situation, including whether the outside gain is lower or higher than the inside gain attributable to ineligible property and whether there are inside gains in respect of other partnership property.

Three examples of the application of subparagraph 88(1)(*d*)(ii.1) are provided below.

Example 1

Example 1 shows a situation in which the outside gain of a subsidiary's interest in a partnership equals the total inside gains in respect of all property held by the partnership.

Facts

- *The fair market value (FMV) of the subsidiary's 99.9% interest in Partnership ABC at the time control of the subsidiary is last acquired by the parent is $100,000 and the adjusted cost base (ACB) of the interest at that time is $70,000. Therefore, an unrealized gain of $30,000 exists in respect of the partnership interest.*
- *Partnership ABC holds two properties at the time control of the subsidiary is last acquired by the parent, one of which is land and the other is depreciable property (a building).*
    - *In the case of the land, its FMV is $10,000 and its ACB is $5,000.*
    - *In the case of the building, its FMV is $90,000 and its undepreciated capital cost (UCC) is $65,000.*
    - *Consequently:*
        - *The combined FMV of the two partnership properties is $100,000 and the combined tax cost is $70,000 ($5,000 + $65,000).*
        - *The FMV of the subsidiary's partnership interest ($100,000) equals the FMV of the land and building ($100,000).*
        - *The outside gain ($30,000) equals the total inside gains ($30,000 = $5,000 + $25,000).*
        - *The outside ACB of the partnership interest ($70,000) equals the total tax cost of the partnership's two properties ($70,000 = $5,000 + $65,000).*
    - *But for new subparagraph 88(1)(d)(ii.1), if the parent were to wind-up the subsidiary immediately after acquiring control, the bump room in respect of the subsidiary's partnership interest would be, in this example, $30,000 ($100,000 - $70,000).*
    - *No other factors are relevant.*

Application of subparagraph 88(1)(d)(ii.1)

- *The FMV of the subsidiary's interest in Partnership ABC is deemed to be $75,000 (instead of $100,000). This FMV is calculated as follows: it is the amount that is A – B where*
    - *A is $100,000 (the FMV of the partnership interest without reference to the subparagraph); and*
    - *B is $25,000 ($30,000 x $25,000/$30,000): $25,000 is the portion of the $30,000 outside gain in respect of the partnership interest ($100,000 less its cost amount of $70,000) that may reasonably be regarded as being attributable to*

        (A) in the case of the depreciable property, $25,000 (being its $90,000 FMV minus its $65,000 UCC); and

        (B) in the case of resource property, nil; and

        (C) in the case of non-capital property, nil.

In Example 1, the relationship between the outside gain of $30,000 in respect of the partnership interest and the inside gain in respect of ineligible property ($25,000) is relatively easy to appreciate because the outside gain and the total inside gains are equal. The portion of the $30,000 outside gain that is reasonably attributable to *the gain on the ineligible property is the $25,000 gain for the ineligible property held by the partnership. The fair market value of the partnership interest is thus reduced from $100,000 to $75,000 by subtracting the $25,000 inside gains in respect of the partnership's ineligible property.*

Example 2

Example 2 concerns a situation in which the outside gain in respect of the partnership interest is less than the total inside gains in respect of property held by the partnership.

Facts

- *The fair market value (FMV) of the subsidiary's 99.9% interest in Partnership ABC at the time control of the subsidiary is last acquired by the parent is $100,000 and the adjusted cost base (ACB) of the interest at that time is $70,000. Therefore, an unrealized gain of $30,000 exists in respect of the partnership interest.*
- *Partnership ABC holds two properties at the time control of the subsidiary is last acquired by the parent, one of which is land and the other is depreciable property (a building).*
  - *In the case of the land, its FMV is $10,000 and its ACB is $5,000.*
  - *In the case of the building, its FMV is $90,000 and its undepreciated capital cost (UCC) is $35,000.*
  - *Consequently:*
    - *The combined FMV of the two properties is $100,000 and the combined tax cost is $40,000 ($5,000 + $35,000).*
    - *The FMV of the subsidiary's partnership interest ($100,000) equals the FMV of the land and building ($100,000).*
    - *The outside gain ($30,000) is less than the total inside gains ($60,000 = $5,000 + $55,000).*
    - *The outside ACB of $70,000 in respect of the partnership interest exceeds the total tax cost of $40,000 in respect of the partnership's two properties ($5,000 + $35,000).*
- *But for new subparagraph 88(1)(d)(ii.1), if the parent were to wind-up the subsidiary immediately after acquiring control, the bump room in respect of the subsidiary's partnership interest would be, in this example, $30,000 ($100,000 - $70,000).*
- *No other factors are relevant.*

Application of subparagraph 88(1)(d)(ii.1)

- *The FMV of the subsidiary's interest in Partnership ABC is deemed to be $72,500 (instead of $100,000). This FMV is calculated as follows: it is the amount that is A – B where*
  - *A is $100,000 (the FMV of the partnership interest determined without reference to the subparagraph); and*
  - *B is $27,500 ($30,000 x $55,000/$60,000), which is the portion of the amount of $30,000 – the FMV of the partnership interest ($100,000) less the cost amount ($70,000) of the interest – that may reasonably be regarded as being attributable to*

    (A) in the case of the depreciable property, $55,000 (being its $90,000 FMV minus its $35,000 UCC); and

    (B) in the case of resource property, nil; and

(C) in the case of non-capital property, nil.

In Example 2, the amount of variable B is $27,500 because the unrealized outside gain of $30,000 is attributable to <u>both</u> the unrealized gain and recapture in respect of the depreciable property ($55,000) and the unrealized gain in respect of the land ($5,000). Consequently, the portion of the outside gain that may reasonably be regarded as being attributable to the building is based on an apportionment of the outside gain to the inside gains in respect of the two properties held by the partnership (i.e., $27,500 = $30,000 x $55,000/$60,000).

Example 3

Example 3 is a situation in which the outside gain in respect of the partnership interest exceeds the total inside gains in respect of the partnership's properties.

Facts

- *The fair market value (FMV) of the subsidiary's 99.9% interest in Partnership ABC at the time control of the subsidiary is last acquired by the parent is $100,000 and the adjusted cost base (ACB) of the interest at that time is $70,000. Therefore, an unrealized gain of $30,000 exists in respect of the partnership interest.*
- *Partnership ABC holds two properties at the time control of the subsidiary is last acquired by the parent one of which is land and the other is depreciable property (a building).*
  - *In the case of the land, its FMV is $30,000 and its ACB is $20,000.*
  - *In the case of the building, its FMV is $70,000 and its undepreciated capital cost (UCC) is $60,000.*
  - *Consequently:*
    - *The combined FMV of the two properties is $100,000 and the combined tax cost is $80,000 ($20,000 + $60,000).*
    - *The FMV of the subsidiary's partnership interest ($100,000) equals the FMV of the land and building ($100,000).*
    - *The outside gain ($30,000) exceeds the inside gain ($20,000 = $10,000 + $10,000).*
    - *The outside ACB of $70,000 in respect of the partnership interest is less than the total tax cost of $80,000 of the partnership's two properties.*
- *But for new subparagraph 88(1)(d)(ii.1), if the parent were to wind-up the subsidiary immediately after acquiring control, the bump room in respect of the subsidiary's partnership interest would be, in this example, $30,000 ($100,000 - $70,000).*
- *No other factors are relevant.*

Application of subparagraph 88(1)(d)(ii.1)

- *The FMV of the subsidiary's interest in Partnership ABC is deemed to be $90,000 (instead of $100,000). This FMV is calculated as follows: it is the amount that is A – B where*
  - *A is $100,000, the FMV of the partnership interest (determined without reference to the subparagraph); and*
  - *B is $10,000, which is the portion of the amount of $30,000 – the FMV of the partnership interest ($100,000) less the cost amount ($70,000) of the interest – that may reasonably be regarded as being attributable to*

(A) in the case of the depreciable property, $10,000 (being its $70,000 FMV minus its $60,000 UCC); and

(B) in the case of resource property, nil; and

(C) in the case of non-capital property, nil.

In Example 3, the amount of variable B is $10,000 because it is reasonable to conclude that only $10,000 of the $30,000 outside gain is attributable to the depreciable property held by the partnership. In calculating the amount of variable B, the reference in the description to "may reasonably regarded as being attributable" to gains in respect of ineligible property generally means that the reduction in the fair market value of the partnership interest under subparagraph 88(1)(d)(ii.1) is not expected, in normal circumstances, to exceed the total of all gains attributable to ineligible property held, directly or indirectly, by the partnership.

Examples 1 to 3 show that the calculation of the deemed fair market value of a subsidiary corporation's interest in a partnership under subparagraph 88(1)(*d*)(ii.1) depends on a number of factors, including the unrealized outside gain in respect of the partnership interest held by the subsidiary and the unrealized gain and recapture existing in respect of ineligible property and other property held, directly or indirectly, by the partnership.

To ensure that subparagraph 88(1)(*d*)(ii.1) is effective, new paragraph 88(1)(*e*) and new subsection 97(3) are also introduced. In general, paragraph 88(1)(*e*) applies to certain transfers of ineligible property to a partnership in which an interest is held by a subsidiary (either directly or indirectly) before the parent's acquisition of control of the subsidiary, while subsection 97(3) applies to certain transfers of property to a partnership after the parent acquires control of the subsidiary. For further information, please see the commentary on those two provisions.

It is recognized that a subsidiary may wish to transfer ineligible property to a taxable Canadian corporation before there is an acquisition of control of the subsidiary in order to preserve the bump room that would otherwise be, but for subparagraph 88(1)(*d*)(ii.1), available in respect of the partnership interest. Consequently, subparagraph 88(1)(*d*)(ii.1) does not reduce the fair market value of a partnership interest by the unrealized gains and recapture income existing in respect of shares of a taxable Canadian corporation held by the partnership, even if properties held by the corporation are ineligible properties.

In general, subparagraph 88(1)(*d*)(ii.1) applies after March 28, 2012. An exception is provided where a taxable Canadian corporation (referred to as the "parent corporation") has acquired control of another taxable Canadian corporation (referred to as the "subsidiary corporation") – in general, the exception applies for an amalgamation of the parent and the subsidiary corporation that occurs before 2013 or a winding-up of the subsidiary corporation into the parent corporation that begins before 2013, if

- the parent corporation acquired control of the subsidiary corporation before March 29, 2012, or was obligated as evidenced in writing before March 29, 2012 to acquire control of the subsidiary (except that the parent corporation shall not be considered to be obligated if, as a result of amendments to the Act, it may be excused from the obligation to acquire control), and
- the parent corporation had the intention as evidenced in writing before March 29, 2012 to amalgamate with, or wind up, the subsidiary corporation.

ITA
88(1)(*e*)

New paragraph 88(1)(*e*) of the Act provides an anti-avoidance rule that, if applicable, reduces the fair market value of a subsidiary's partnership interest for the purpose of applying the description of A in the formula in subparagraph 88(1)(*d*)(ii.1). In particular, the fair market value of an interest in a particular partnership held by the subsidiary at the time the parent last acquired control of the subsidiary is deemed not to include the amount that is the total of each amount that is the fair market value of a property that would otherwise be included in the fair market value of the interest, if

- as part of a series of transactions or events in which control of the subsidiary (that holds an interest in a particular partnership) is last acquired by the parent and on or before the acquisition of control,
    - the subsidiary disposes of the property to the particular partnership or any other partnership and subsection 97(2) applies to the disposition, or
    - the subsidiary acquires an interest in a partnership from a person or partnership with whom it does not deal at arm's length (otherwise than because of a right referred to in paragraph 251(5)(*b*)) and section 85 applies to the acquisition; and
- at the time of the acquisition of control of the subsidiary, the particular partnership holds, directly or indirectly through one or more other partnerships, ineligible property described in clauses (A) to (C) of the description of B in subparagraph 88(1)(*d*)(ii.1).

Paragraph 88(1)(*e*) is meant to address transfers of property under subsection 97(2) to a partnership, or of an interest in a partnership under section 85, before the parent acquires control of the subsidiary corporation (during the series of transactions in which control is acquired) in circumstances where the transfers are made to change the factors that may be relevant when applying the formula in subparagraph 88(1)(*d*)(ii.1).

Generally, new paragraph 88(1)(*e*) applies after August 13, 2012. However, paragraph 88(1)(*e*) does not apply to a disposition that occurs before 2013 pursuant to an obligation under a written agreement entered into before August 14, 2012 by parties that deal with each other at arm's length and no party to the agreement may be excused from the obligation as a result of amendments to the Act.

Clause 19

Paid-up capital

ITA
89(1)

Subsection 89(1) of the Act defines the term "paid-up capital" for the purposes of various provisions of the Act. Paragraph (*b*) of that definition defines "paid-up capital" in respect of a class of shares of the capital stock of a corporation and subparagraph (*b*)(iii) makes it explicit that various provisions of the Act are to be taken into account in determining paid-up capital of a class.

Subparagraph (*b*)(iii) of the definition "paid-up capital" in subsection 89(1) is amended, consequential on the introduction of the foreign affiliate dumping rules, to add references to new paragraph 128.1(1)(*c.3*) and new section 212.3.

This amendment comes into force on March 29, 2012.

Clause 20

Shares held by a partnership

ITA
93.1(1)

Subsection 93.1(1) of the Act applies for the purpose of determining whether a non-resident corporation is a foreign affiliate of a corporation resident in Canada, for certain enumerated provisions of the Act and the *Income Tax Regulations*, where the Canadian corporation owns the non-resident corporation's shares through a partnership. In this regard, subsection 93.1(1) deems the Canadian corporation to own its proportionate number of the non-resident corporation's shares based on its relative fair market value interest in the partnership.

Subsection 93.1(1) is amended, consequential on the introduction of the foreign affiliate dumping rules, to add references to new paragraph 128.1(1)(*c.3*), new section 212.3 and new subsection 219.1(2) to its list of enumerated provisions.

This amendment comes into force on March 29, 2012.

Clause 21

Acquisition of property by partnership

ITA
97

Section 97 of the Act sets out rules that apply when a partnership acquires property from a taxpayer.

Rules if election by partners

ITA
97(2)

Subsection 97(2) of the Act sets out rules which allow a taxpayer to transfer certain types of property on a tax-deferred basis to a Canadian partnership. Subsection 97(2) is amended to make it subject to new subsection 97(3), which is described below.

This amendment applies in respect of dispositions made after March 28, 2012.

Election not available – section 88

ITA
97(3)

New subsection 97(3) of the Act provides that the tax-deferred transfer rule in subsection 97(2) does not apply to certain dispositions of property made by a taxpayer to a Canadian partnership in which a subsidiary (referred to in subsection 88(1)) holds an interest if the disposition occurs after control of the subsidiary is acquired by its parent (referred to in subsection 88(1)). This anti-avoidance rule is meant to ensure that property that is not eligible for a cost base increase or "bump" under paragraph 88(1)(*c*) (ineligible property) is not transferred on a tax-deferred basis under subsection 97(2) to a partnership of the subsidiary after control of the subsidiary is acquired by the parent in circumstances that would seek to frustrate the purpose of new subparagraph 88(1)(*d*)(ii.1), which operates to reduce the fair market value of a subsidiary's partnership interest in certain circumstances. For further information, see the commentary for new subparagraph 88(1)(*d*)(ii.1).

New subsection 97(3) applies to preclude the application of subsection 97(2) to a disposition of property to a particular partnership if

- as part of a transaction or event or series of transactions or events that includes the disposition
  - control of a taxable Canadian corporation (the subsidiary) is acquired by another taxable Canadian corporation (the parent),
  - the subsidiary is wound-up under subsection 88(1) or amalgamated with one or more corporations under subsection 87(11), and
  - the parent makes a designation under paragraph 88(1)(*d*) in respect of an interest in the partnership;
- the disposition occurs after the acquisition of control of the subsidiary;
- the particular partnership acquires property that is ineligible for the bump (for example, depreciable property, inventory and resource property) or is an interest in a partnership that holds such property; and

- the subsidiary is the taxpayer or has, before the disposition of the property, directly or indirectly in any manner whatever, an interest in the taxpayer.

For example, new subsection 97(3) may apply in the following situations:

1. A taxable Canadian corporation (the Subsidiary) has an interest in Partnership ABC at the time another taxable Canadian corporation (the Parent) acquires control of the Subsidiary. The Subsidiary seeks to transfer ineligible property under subsection 97(2) to Partnership ABC after the acquisition of control of the Subsidiary by the Parent.
2. A taxable Canadian corporation (the Subsidiary) has an interest in Partnership ABC. Partnership ABC, in turn, has an interest in Corporation Y at the time another taxable Canadian corporation (the Parent) acquires control of the Subsidiary. Corporation Y, either prior to the time Parent acquired control of Subsidiary or after that time, has an interest in Partnership XYZ (the taxpayer). Partnership XYZ seeks to transfer ineligible property under subsection 97(2) to Partnership ABC after the acquisition of control of the Subsidiary by the Parent.

New subsection 97(3) applies in respect of dispositions made after March 28, 2012.

Clause 22

Disposition of an interest in a partnership

ITA
100(1)

Subsection 100(1) of the Act provides that a taxpayer's taxable capital gain for a taxation year from the disposition of an interest in a partnership to any person exempt from tax under section 149 is one-half of the portion of the taxpayer's capital gain from the disposition that can reasonably be attributed to increases in value of capital property other than depreciable property of the partnership plus the whole of the remaining portion of the gain.

Subsection 100(1) is amended to extend its application.

First, the preamble of subsection 100(1) is amended so that the subsection applies when, as part of a transaction or event or series of transactions or events, there is a disposition of a partnership interest and an acquisition by a person or partnership described in any of new paragraphs 100(1.1)(*a*) to (*d*). In general, subsection 100(1) will apply when a person that is exempt from tax under section 149 or a non-resident person acquires a partnership interest. The commentary on subsection 100(1.1) provides further information, including with respect to the operation of look-through rules that apply to a disposition of a partnership interest where the interest is acquired by another partnership or a trust.

Second, paragraph 100(1)(*a*) – which applies to one-half of the portion of the taxpayer's capital gain from the disposition that can reasonably be attributed to increases in value of non-depreciable capital property of the partnership – is amended to ensure that paragraph 100(1)(*b*) applies to depreciable property and to property that is not capital property (e.g., eligible capital property, inventory and resource property) if held indirectly by a partnership through one or more other partnerships.

Generally, amended subsection 100(1) applies to dispositions of an interest in a partnership made by a taxpayer after March 28, 2012. Transitional relief is provided for certain dispositions completed before August 14, 2012, or before 2013 pursuant to an arm's length agreement entered into before March 29, 2012.

Acquisition by certain persons or partnerships

ITA
100(1.1)

New subsection 100(1.1) of the Act provides that subsection 100(1) applies in respect of a disposition of a partnership interest by a taxpayer if the interest is acquired by certain persons or partnerships.

Paragraphs 100(1.1)(*a*) and (*b*) refer to direct acquisitions of the taxpayer's interest in a partnership by a person exempt from tax under section 149 or a non-resident person, respectively. A non-resident person includes a non-resident trust.

Paragraphs 100(1.1)(*c*) and (*d*) provide look-through rules where the partnership interest is acquired by another partnership or by a trust resident in Canada (other than a mutual fund trust), referred to as the "purchasing partnership" and "purchasing trust", respectively. In general, these rules look through a purchasing partnership or purchasing trust to ensure that subsection 100(1) applies appropriately to the taxpayer's disposition of an interest in a partnership.

In the case of paragraph 100(1.1)(*c*), the look-through rule applies to the extent that the partnership interest acquired by the purchasing partnership can reasonably be considered to be held indirectly through one or more partnerships by a person that is

- exempt from tax under section 149,
- a non-resident person, or
- a trust resident in Canada (other than a mutual fund) if
    - an interest as a beneficiary under the trust is held directly or indirectly through one or more partnerships by a person exempt from tax under section 149 or a trust (other than a mutual fund trust), and
    - the total fair market value of the interests as beneficiaries under the trust held by a person exempt from tax under section 149 or by another trust (other than a mutual fund trust) exceeds 10 % of the total fair market value of all interests as beneficiaries under the trust.

In the case of paragraph 100(1.1)(*d*), the look-through rule applies to the extent that the purchasing trust can reasonably be considered to have a beneficiary that is, in general terms, a person exempt from tax under section 149. This rule will apply where:

- a partnership is a beneficiary under the purchasing trust;
- one or more persons that are exempt from tax or are trusts (other than mutual fund trusts) are, directly or indirectly, members of the partnership; and
- the total fair market value of the interests held, directly or indirectly, by all such persons in the partnership exceeds 10% of the fair market value of all the interests in the partnership.

Similarly, the rule will also apply where:

- another trust (other than a mutual fund trust) is a beneficiary under the purchasing trust;
- one or more beneficiaries under the other trust are exempt from tax, are partnerships or are trusts (other than mutual fund trusts); and
- the total fair market value of the interests held as beneficiaries under the other trust by all such persons and partnerships exceeds 10% of the fair market value of all the interests as beneficiaries under the other trust.

Example 1

Facts

- *Taxpayer A disposes of an interest in Partnership ABC to Partnership XYZ and realizes a capital gain of $100,000 from the disposition.*
- *100% of the assets of Partnership ABC consist of resource property.*

- *40% of the interests in Partnership XYZ are held by persons exempt from tax under section 149 or by non-resident persons.*
- *60% of the interests in Partnership XYZ are held by taxable persons.*

Calculation of Taxpayer A's taxable capital gain under subsection 100(1)

- *By reason of subsection 100(1.1), 40% of Taxpayer A's disposition (40% of the $100,000 capital gain) of its interest in Partnership ABC is subject to subsection 100(1). That is, 40% is the percentage representing the extent to which the interest in Partnership ABC disposed of by Taxpayer A was acquired by persons exempt from tax or by non-resident persons through Partnership XYZ.*
- *The taxable capital gain of Taxpayer A resulting from the disposition of the interest in Partnership ABC after applying subsection 100(1) is $70,000, calculated as follows:*
    - *$30,000 (50% of the $60,000 portion of capital gain that is not subject to subsection 100(1)); and*
    - *$40,000 (100% of the $40,000 portion of the gain under paragraph 100(1)(b)).*

Example 2

Facts

- *Taxpayer A disposes of an interest in Partnership ABC to Partnership XYZ and realizes from the disposition a capital gain of $100,000.*
- *100% of the assets of Partnership ABC consist of depreciable property.*
- *40% of the interests in Partnership XYZ are held by persons exempt from tax under section 149 or by non-resident persons.*
- *30% of the interests in Partnership XYZ are held by Partnership MNO, and 50% of the members of Partnership MNO are persons exempt from tax under subsection 149 or non-resident persons.*
- *30% of the interests in Partnership XYZ are held by Trust M (which is a resident of Canada and is not a mutual fund trust), and 50% of the beneficiaries of Trust M are persons exempt from tax under section 149.*

Calculation of Taxpayer A's taxable capital gain under subsection 100(1)

- *By reason of subsection 100(1.1), 85% of Taxpayer A's disposition of its interest in Partnership ABC is subject to subsection 100(1). That is, 85% is the total of*
    - *40% - the percentage representing the extent to which the interest in Partnership ABC disposed of by Taxpayer A is held by persons who are exempt from tax or are non-resident through Partnership XYZ.*
    - *15% - the percentage representing the extent to which the interest in Partnership ABC disposed of by Taxpayer A is held by persons who are exempt from tax under section 149 or non-resident persons through Partnership XYZ and Partnership MNO (Partnership MNO has a 30% interest in Partnership XYZ and a 50% interest in Partnership MNO is held by persons exempt from tax or by non-resident persons). The term "to the extent that" directs that one or more partnerships be looked-through to the portion held by such persons.*
    - *30% - the percentage representing the extent to which the interest in Partnership ABC disposed by Taxpayer A is held through Partnership XYZ by Trust M, and more than 10% of the fair*

market value of the interests under Trust M are held by persons that are exempt from tax under section 149.

- *The taxable capital gain of Taxpayer A resulting from the disposition of the interest in Partnership ABC after applying subsection 100(1) is $92,500 calculated as follows:*
    - *$7,500 (50% of the $15,000 portion of capital gain that is not subject to subsection 100(1)); and*
    - *$85,000 ($100% of the $85,000 portion of the gain under paragraph 100(1)(b)).*

Examples 1 and 2 do not consider the case where a trust resident in Canada (other than a mutual fund trust) acquires the partnership interest disposed of by Taxpayer A. In such a case, the term "to the extent that" of paragraph 100(1.1)(*d*) looks through the acquiring trust to its beneficiaries.

It should be noted that subsection 100(1.2) provides a 10% *de minimis* exception from the application of paragraphs 100(1.1)(*c*) and (*d*).

New subsection 100(1.1) comes into force on August 14, 2012. Transitional relief is provided for certain transactions completed before 2013 pursuant to an arm's length agreement entered into before August 14, 2012.

De minimis

ITA
100(1.2)

New subsection 100(1.2) of the Act provides a 10% *de minimis* exception from the application of the look-through rule in paragraphs 100(1.1)(*c*) and (*d*). The exception applies to a taxpayer's disposition of a partnership interest to a partnership or trust (other than a discretionary trust) if the extent to which subsection 100(1) would, but for new subsection 100(1.2), apply to the taxpayer's disposition does not exceed 10% of the taxpayer's interest.

New subsection 100(1.2) comes into force on August 14, 2012. Transitional relief is provided for certain transactions completed before 2013 pursuant to an arm's length agreement entered into before August 14, 2012.

Exception – non-resident person

ITA
100(1.3)

New subsection 100(1.3) of the Act provides an exception from the application of subsection 100(1) in respect of the disposition of a partnership interest to a non-resident person. The exception applies to the disposition if

- property of the partnership is used, immediately before and immediately after the acquisition of the interest by the non-resident person, in carrying on business through one or more permanent establishments in Canada; and
- the total fair market value of the partnership's property equals at least 90% of the total fair market value of all property of the partnership.

The definition "permanent establishment" in section 8201 of the *Income Tax Regulations* is amended consequential on this amendment.

New subsection 100(1.3) comes into force on March 29, 2012.

Anti-avoidance – dilution

ITA
100(1.4)

New subsection 100(1.4) of the Act, together with subsection 100(1.5), provide an anti-avoidance rule that applies where partnership interests are created or changed in a way that is economically equivalent to a direct disposition of a partnership interest without a disposition of an interest having been made. Subsection 100(1.4) provides that if two conditions are met, subsection 100(1.5) will apply. The first condition is that it is reasonable to conclude that one of the purposes of a dilution, reduction or alteration of a partnership interest is to avoid the application of subsection 100(1) in respect of the partnership interest. The second condition is that there be, as part of a transaction or event or series of transactions or events that includes the dilution, reduction or alteration,

- an acquisition of an interest in the partnership by a person or partnership described in any of paragraphs 100(1.1)(*a*) to (*d*); or
- an increase in, or alteration of, an interest in the partnership held by a person or partnership described in any of paragraphs 100(1.1)(*a*) to (*d*).

New subsection 100(1.4) comes into force on August 14, 2012. Transitional relief is provided for certain transactions completed before 2013 pursuant to an arm's length agreement entered into before August 14, 2012.

Deemed gain – dilution

ITA
100(1.5)

If the conditions in subsection 100(1.4) of the Act are met, subsection 100(1.5) provides that, for the purposes of subsection 100(1),

- the taxpayer is deemed to have disposed of an interest in the relevant partnership at the time of the dilution, reduction or alteration. Dilution includes the diminishment of, or the lessening of the value of, the partnership interest;
- the taxpayer is deemed to have a capital gain from the disposition equal to the amount by which the fair market value of the particular interest immediately before the dilution, reduction or alteration exceeds its fair market value immediately thereafter; and
- a person or partnership referred to in paragraph 100(1.4)(*b*) – in general terms, a person exempt from tax under section 149 or a non-resident person – is deemed to have acquired an interest in the partnership as part of the transaction or event or series of transactions or events that includes the deemed disposition. This deeming rule is meant to ensure that the requirements in subsection 100(1) – that there be both a disposition and acquisition of a partnership interest – are met.

Subsection 100(1.5) comes into force on August 14, 2012. Transitional relief is provided for certain transactions completed before 2013 pursuant to an arm's length agreement entered into before August 14, 2012.

Clause 23

Trust – definition

ITA
108(1)

"trust"

Section 108 of the Act provides 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. For the purposes of the 21-year deemed disposition rule and other specified measures, subsection 108(1) defines trust to exclude certain trusts. Under paragraph (*a*) of the definition "trust", trusts governed by registered retirement savings plans and a number of other special income plans are among those trusts excluded for these purposes.

As a consequence of the introduction of pooled registered pension plans (PRPPs) and the income tax rules to accommodate them, paragraph (*a*) of the definition "trust" is amended to add a reference to PRPPs as excluded trusts for these purposes. For further information regarding PRPPs, please see the commentary to new section 147.5.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 24

Capital gains exemption - definitions

ITA
110.6(1)

"investment expense"

The definition "investment expense" in subsection 110.6(1) of the Act applies for the purposes of determining an individual's "cumulative net investment loss". An increase in an individual's investment expenses can result in an increase in an individual's cumulative net investment loss and a consequential decrease in the individual's entitlement to the capital gains exemption under section 110.6. Paragraph (*a*) of the definition excludes certain deductible expenses from an individual's investment expense, including deductions claimed in respect of indebtedness incurred for the purposes of making contributions to a registered pension plan or deferred profit sharing plan or paying premiums to a registered retirement savings plan.

Paragraph (*a*) of the definition is amended, consequential on the introduction of section 147.5 pertaining to pooled registered pension plans (PRPPs), so that deductions claimed in respect of indebtedness incurred for the purpose of making contributions to a PRPP will be also excluded from an individual's investment expense. Specifically, clause (*a*)(i)(C) is amended by adding a reference to "pooled registered pension plan". Since paragraph 18(11)(*c*) is concurrently amended to prohibit the deduction of interest on money borrowed to make a PRPP contribution (other than an employer contribution), this amendment will be effective only to exclude deductible expenses in respect of an individual's indebtedness in relation to PRPP contributions made *as an employer*.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 25

PRPP – pension credit and income splitting

ITA
118(7)

"pension income"

The definition "pension income" in subsection 118(7) of the Act applies for the purposes of the pension credit provisions in subsection 118(3) and is used in the pension income splitting provisions in section 60.03.

Subparagraph (*a*)(i) of the definition "pension income" refers to life annuity payments from a superannuation or pension plan. Subparagraph (*a*)(i) of the definition "pension income" is amended to exclude life annuity payments out of or under a pooled registered pension plan (PRPP). Subparagraph (*a*)(iii.2) is added to the definition to include in pension income any amounts included in the taxpayer's income under new section 147.5. As a result, taxable benefits paid out of or under a PRPP (including variable benefits and payments from a PRPP qualifying annuity) are eligible for the pension credit and pension income splitting on amounts received after the taxpayer has attained 65 years of age.

For further information, please see the commentary on section 147.5, and in particular, the commentary on new subsections 147.5(1), (5), (21) and (23) regarding qualifying annuities and variable benefits for PRPP purposes.

These amendments will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 26

Overseas employment tax credit

ITA
122.3

Section 122.3 of the Act currently provides an "overseas employment tax credit" (OETC) to individuals resident in Canada who are employed for at least six consecutive months in a foreign country by a specified employer in connection with a resource, construction, installation, agricultural or engineering project. Section 122.3 is amended to phase out the OETC. During the phase-out period, the factor (currently 80%) applied to an employee's qualifying foreign employment income in determining the employee's OETC will be reduced to 60% for the 2013 taxation year, 40% for the 2014 taxation year and 20% for the 2015 taxation year. At the same time, the maximum qualifying foreign employment income eligible for the OETC (currently $80,000) will be correspondingly reduced. The OETC will be eliminated for the 2016 and subsequent taxation years.

The phase-out rules will not apply with respect to qualifying employment income earned by an employee in connection with a project or activity to which the employee's employer had committed in writing before March 29, 2012. For example, if an employer has tendered an irrevocable bid in writing for a project before March 29, 2012, the employer will be considered to have committed in writing to the project irrespective of whether the bid has been accepted before March 29, 2012. In this case, the factor applied to an employee's qualifying foreign employment income in determining the employee's OETC will remain 80% for the 2013, 2014 and 2015 taxation years. The OETC will be eliminated for the 2016 and subsequent taxation years and will not be available to the employee after 2015.

Deduction from tax payable where employment out of Canada

ITA
122.3(1)(*c*) and (*d*)

The OETC is determined by multiplying an employee's Part I tax otherwise payable for a taxation year by a fraction: the numerator of that fraction, determined under paragraphs 122.3(1)(*c*) and (*d*) of the Act, consists of the lesser of $80,000 and 80% of the individual's overseas employment income for the year; and the denominator of that fraction, determined under paragraph 122.3(1)(*e*), is the individual's income for the year reduced by certain deductions listed in subparagraph 122.3(1)(*e*)(iii). The $80,000 figure set out in paragraph 122.3(1)(*c*) is reduced, on a prorated basis, if the number of days in the "qualifying period" or on which the individual was resident in Canada that are in the year is less than 365.

Paragraph 122.3(1)(*c*) is amended to replace "$80,000" with "the specified amount for the year", which is defined in new subsection 122.3(1.01). Paragraph 122.3(1)(*d*) is amended to replace "80%" with "the specified percentage for the year", which is defined in new subsection 122.3(1.02). These amendments provide transitional rules for the phase out of the OETC. The formulas in new subsections 122.3(1.01) and (1.02) determine the extent to which an employee's income is eligible for the OETC.

Specified amount

ITA
122.3(1.01)

New subsection 122.3(1.01) of the Act defines the term "specified amount" for the purposes of paragraph 122.3(1)(*c*). The specified amount for the 2013 to 2015 taxation years is determined by the formula [$80,000 x A/(A+B)] + [C x B/(A+B)].

Amount A is the individual's income described in paragraph 122.3(1)(*d*) for the taxation year that is earned in connection with a contract that was committed to in writing before March 29, 2012 by a specified employer of the individual.

Amount B is the individual's income described in paragraph 122.3(1)(*d*) for the taxation year, other than income included in the description of A.

Amount C is $60,000 for the 2013 taxation year, $40,000 for the 2014 taxation year and $20,000 for the 2015 taxation year.

The specified amount is nil for the 2016 and subsequent taxation years, effectively eliminating the OETC after 2015.

This amendment applies to the 2013 and subsequent taxation years.

Specified percentage

ITA
122.3(1.02)

New subsection 122.3(1.01) defines the term "specified percentage" for the purposes of paragraph 122.3(1)(*d*). The specified percentage for the 2013 to 2015 taxation years is determined by the formula [80% x A/(A+B)] + [C x B/(A+B)] .

Amount A is the individual's income described in paragraph 122.3(1)(*d*) for the taxation year that is earned in connection with a contract that was committed to in writing before March 29, 2012 by a specified employer of the individual.

Amount B is the individual's income described in paragraph 122.3(1)(*d*) for the taxation year, other than income included in the description of A.

Amount C is 60% for the 2013 taxation year, 40% for the 2014 taxation year and 20% for the 2015 taxation year.

The specified percentage is 0% for the 2016 and subsequent taxation years, effectively eliminating the OETC after 2015.

This amendment applies to the 2013 and subsequent taxation years.

Clause 27

Deductions from Part I tax

ITA
127

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

Investment tax credit

ITA
127(5)

Subsection 127(5) of the Act provides for the deduction of investment tax credits (ITCs) from a taxpayer's Part I tax otherwise payable for a taxation year. The term "investment tax credit" is defined in subsection 127(9).

Budget 2012 announced a number of changes to the eligibility of expenditures for ITCs. First, the 10% ITC on the cost of property primarily used in oil and gas, and mining activities in Atlantic Canada is phased out. Second, the 10% ITC for pre-production mining expenditures is phased out. Third, certain types of electricity generation equipment and clean energy generation equipment used in eligible activities in Atlantic Canada will qualify for the 10% Atlantic ITC. Fourth, the scientific research and experimental development (SR&ED) expenditures eligible for ITCs will be changed as follows:

- Expenditures of a capital nature no longer qualify for ITCs.
- The rate at which overhead SR&ED expenditures are accounted for under the proxy method for ITC purposes is reduced from 65% to 55%.
- Only 80% of expenditures in respect of third-party arm's length payments for SR&ED are eligible for ITC.
- The basic 20% ITC rate for SR&ED qualified expenditures is reduced to 15%.

Definitions

ITA
127(9)

Subsection 127(9) of the Act provides various definitions relevant for the purpose of calculating the investment tax credits of taxpayers.

"contract payment"

The definition "contract payment" in subsection 127(9) avoids the duplication of investment tax credits (ITCs) where a person performing scientific research and experimental development (SR&ED) receives payments or compensation from another person in respect of that SR&ED. The definition "contract payment" is relevant only for SR&ED expenditures of arm's length parties.

There are a number of ways in which SR&ED can be performed. Taxpayers can perform SR&ED in-house, have someone else perform the SR&ED on their behalf (contract-SR&ED), or make payments for SR&ED to be carried on by certain third-party entities (third-party SR&ED).

A taxpayer is entitled to claim ITCs in respect of a "qualified expenditure" as defined in subsection 127(9). In the case of contract-SR&ED and third-party SR&ED, qualified expenditures of a performer are reduced by the amount of a payor's contract payment to the performer. This ensures that both the payor and the performer cannot claim ITCs on the same qualified expenditure. The definition "contract payment" is amended in two respects.

First, subparagraph (*a*)(i) of the definition "contract payment" is amended, consequential on the introduction of new subparagraph 37(1)(*a*)(i.01), to replace the reference to subparagraph 37(1)(*a*)(i) with a reference to subparagraph 37(1)(*a*)(i.01).

Second, paragraph (*b*) of the definition "contract payment" is amended, consequential on the repeal of paragraph 37(1)(*b*), to ensure that only expenditures of a current nature are relevant for the purposes of the definition.

The amendment to subparagraph (*a*)(i) of the definition applies in respect of expenditures made after 2012 and the amendment to paragraph (*b*) applies in respect of expenditures made after 2013.

"first term shared-use-equipment"

The definition "first term shared-use-equipment" in subsection 127(9) describes certain depreciable property of a taxpayer that is eligible for an investment tax credit (ITC). An expenditure of a capital nature made by a taxpayer in respect of scientific research and experimental development (SR&ED) carried on in Canada is not eligible for an ITC unless the property is used all or substantially all in the prosecution of SR&ED. However, where a property is not all or substantially used by a taxpayer for SR&ED, but is primarily used by the taxpayer in SR&ED (referred to as shared-use-equipment), part of the cost of such property can be included in the taxpayer's "qualified expenditure" as defined in subsection 127(9), and therefore is partially eligible for an ITC.

The definition “first term shared-used-equipment” is amended as of March 29, 2012, consequential on the repeal of paragraph 37(1)(*b*), to ensure that it will only apply in respect of property acquired before 2014.

Because of the interaction of the definition “first term shared-use-equipment” with the definition “second term shared-use-equipment” in subsection 127(9), ITCs may still be claimed in taxation years ending after 2013 in respect of first term shared-use-equipment acquired before 2014. As a result of this interaction, ITCs will not be available to any corporation in respect of either first term shared-use-equipment or second term shared-use-equipment for a taxation year that ends after February 1, 2017.

“investment tax credit”

The definition “investment tax credit” in subsection 127(9) provides for the calculation of a taxpayer’s investment tax credits (ITCs) at the end of a taxation year and also ensures that a tax credit is not generated in circumstances where the business income to which a cost or expenditure relates is not subject to income tax. Paragraphs (*a*), (*a.1*) and (*a.3*) of the definition are amended to implement several Budget 2012 proposals.

Paragraph (*a*) of the definition “investment tax credit” provides for the inclusion of the total of all amounts each of which is the specified percentage of the capital cost to a taxpayer of certified property or qualified property acquired by the taxpayer in the year. This paragraph is amended to remove the reference to “certified property” which is no longer relevant (since such property generally cannot be acquired after 1995), and to add a reference to “qualified resource property.”

Paragraph (*a.1*) of the definition “investment tax credit” provides for the inclusion of 20% of the amount by which a taxpayer’s SR&ED qualified expenditure pool for a year exceeds the taxpayer’s super-allowance benefit amount for the year. Budget 2012 announced that the 20% rate would be reduced to 15%. Paragraph (*a.1*) is amended by replacing the reference to 20% with 15%.

Paragraph (*a.3*) of the definition “investment tax credit” provides for the inclusion of a specified percentage (10% for expenditures incurred after 2004) of a pre-production mining expenditure incurred by a taxable Canadian corporation in a taxation year. The paragraph is amended consequential on the introduction of new subparagraphs (*a*)(i) and (ii) in the definition “pre-production mining expenditure” in subsection 127(9).

The amendments to paragraphs (*a*) and (*a.3*) of the definition “investment tax credit” apply to taxation years ending after March 28, 2012.

The amendment to paragraph (*a.1*) of the definition “investment tax credit” to reduce the SR&ED ITC rate from 20% to 15% applies to taxation years that end after 2013, except that, for taxation years that include January 1, 2014, the 5 percentage point reduction in the rate is pro-rated based on the number of days in the taxation year that are after 2013.

“phase”

The new definition “phase” in subsection 127(9) is added consequential on the introduction of the new definition “qualified resource property” in subsection 127(9).

Budget 2012 announced the phase out of the 10% investment tax credits available for certain assets used in the Atlantic provinces, the Gaspé Peninsula and their associated offshore regions (commonly referred to as the “Atlantic ITC”). The Budget proposal phases out the 10% Atlantic ITC for the cost of property primarily used in oil and gas, and mining activities. Subject to grandfathering, the 10% Atlantic ITC will be reduced to 5% for such assets acquired in 2014 and 2015 and to 0% for assets acquired after 2015. Assets acquired before 2017 as part of a grandfathered phase of a project will be eligible for the 10% Atlantic ITC.

The new definition “phase” is relevant for determining if a phase of a taxpayer’s project is a grandfathered phase eligible for transitional relief. In this context, a phase is defined as a discrete expansion in the extraction, processing or production capacity of a project of a taxpayer beyond a capacity level that was attained before March 29, 2012 and which expansion in capacity was the taxpayer’s demonstrated intention immediately before March 29, 2012.

The new definition comes into force on March 29, 2012.

“pre-production mining expenditure”

The definition “pre-production mining expenditure” in subsection 127(9) describes the type of exploration expenses that are eligible for the 10% investment tax credit (ITC) (specified percentage) rate and are included in paragraph (*a.3*) of the definition “investment tax credit”.

Generally, a pre-production mining expenditure is a grass roots exploration or pre-production development expenditure incurred in Canada in respect of qualifying minerals. These expenditures are certain expenses described in paragraphs (*f*) and (*g*) of the definition “Canadian exploration expense” in subsection 66.1(6).

Paragraph (*a*) of the definition “pre-production mining expenditures” is amended consequential on the phase out of the 10% ITC for such expenditures. New subparagraph (*a*)(i) of the definition refers to certain expenses described in paragraph (*f*) of the definition “Canadian exploration expense” in subsection 66.1(6) and new subparagraph (*a*)(ii) refers to certain expenses described in paragraph (*g*) of the definition “Canadian exploration expense” in subsection 66.1(6). The ITC rate (described more fully in the commentary to the definition “specified percentage”) that applies after 2013 for pre-production mining expenditures described in subparagraph (*a*)(i) is different from the rate that applies to pre-production mining expenditures described in subparagraph (*a*)(ii).

In addition paragraph (*a*) of the definition “pre-production mining expenditure” is amended to clarify that subparagraphs (*a*)(i) and (ii) of the definition apply only to expenditures that are “Canadian exploration expenses” as defined in subsection 66.1(6).

The amendment applies with respect to expenditures incurred after March 28, 2012.

“qualified expenditure”

The definition “qualified expenditure” in subsection 127(9) sets out the type of expenditures incurred by a taxpayer on scientific research and experimental development (SR&ED) that are eligible for investment tax credits (ITCs).

Paragraph (*a*) of the definition “qualified expenditure” includes expenditures described in paragraph 37(1)(*a*), subparagraph 37(1)(*b*)(i), and for first term shared-use-equipment and second term shared-use-equipment as those terms are defined in subsection 127(9).

Budget 2012 announced that expenditures of a capital nature will no longer qualify for SR&ED tax incentives and that only 80% of expenditures in respect of third-party arm’s length payments for SR&ED are eligible for ITC. Paragraph (*a*) of the definition “qualified expenditure” is amended in three respects to implement these proposals.

First, the ordering of the subparagraphs in paragraph (*a*) of the definition “qualified expenditure” is changed in order to accommodate the different effective dates of various amendments. In particular,

- subparagraph (*a*)(i) of the definition “qualified expenditure”, which previously referred to an expenditure for first term shared-use-equipment and second term shared-use-equipment, is amended to refer to an expenditure described in subparagraph 37(1)(*a*)(i),
- subparagraph (*a*)(ii) of the definition “qualified expenditure”, which previously referred to an expenditure described in paragraph 37(1)(*a*), is amended to refer to 80% of an expenditure that is described in any of subparagraphs 37(1)(*a*)(i.01) to (iii),
- subparagraph (*a*)(iii) of the definition “qualified expenditure”, which previously referred to an expenditure described in subparagraph 37(1)(*b*)(i), is amended to refer to an expenditure for first term shared-use-equipment and second term shared-use-equipment, and

- new subparagraph (*a*)(iv) of the definition “qualified expenditure” refers to an expenditure described in subparagraph 37(1)(*b*)(i).

These amendments to paragraph (*a*) of the definition “qualified expenditure” apply in respect of expenditures made after 2012.

Second, consistent with the repeal of paragraph 37(1)(*b*), subparagraph (*a*)(iv) of the definition is repealed in respect of expenditures made after 2013.

Third, consistent with the amendment to the definition “first term shared-use-equipment”, amended subparagraph (*a*)(iii) of the definition “qualified expenditure” is repealed as of February 1, 2017.

In addition, paragraph (*b*) of the definition “qualified expenditure”, which refers to a prescribed proxy amount, is amended to remove the reference to paragraph (*e*) of the definition “qualified expenditure”. Paragraph (*e*) had been previously repealed.

The amendment to paragraph (*b*) of the definition “qualified expenditure” applies in respect of expenditures made after 2012.

“qualified property”

The definition “qualified property” in subsection 127(9) provides for the types of property the cost of which is eligible for an investment tax credit (ITC). The types of property are, in general, prescribed buildings and machinery and equipment used primarily for eligible activities generally in Atlantic Canada. Prescribed buildings are described in subsection 4600(1) of the *Income Tax Regulations* and subsection 4600(2) of the *Income Tax Regulations* describes prescribed machinery and equipment.

The definition “qualified property” is amended in five respects. First, the preamble of the definition is amended, consequential on the introduction of the new definition “qualified resource property” in subsection 127(9), to exclude qualified resource property. In addition, the preamble is amended to remove obsolete references to approved project property and certified property.

Second, new paragraph (*b.1*) is added to the definition “qualified property” to include a new type of property, prescribed energy generation and conservation property. Budget 2012 proposed to treat certain electricity generation equipment and clean energy generation equipment used primarily in an eligible activity (that is, farming, fishing, logging, manufacturing and processing, storing grain and harvesting peat) as qualified property. Prescribed energy generation and conservation property, which is described in new subsection 4600(3) of the *Income Tax Regulations*, is depreciable property generally included in any of subparagraph (*a.1*)(i) of Class 17 and Classes 43.1, 43.2 and 48 of Schedule II to the Regulations.

Third, paragraph (*c*) of the definition “qualified property” is amended to exclude property used in oil and gas, and mining activities. For more information on the exclusion, please see the commentary to the new definition “qualified resource property” in subsection 127(9).

Fourth, paragraph (*c.1*) of the definition “qualified property” is amended to exclude prescribed energy generation and conservation property. This amendment ensures that the prescribed energy generation and conservation property will not qualify as “qualified property” eligible for the Atlantic ITCs, if it is used for activities described in paragraph (*c.1*) of the definition “qualified property.”

Fifth, paragraph (*d*) of the definition “qualified property” is amended in two respects. The reference to subparagraphs (*c*)(i) to (xiii) is replaced with a reference to paragraph (*c*) as a consequence of the introduction of the definition “qualified resource property” in subsection 127(9). As well, a reference is added to new paragraph (*b.1*) consequential on the introduction of that paragraph.

These amendments apply in respect of property acquired after March 28, 2012.

“qualified resource property”

The new definition “qualified resource property” is added to subsection 127(9) as a result of the phase out of the 10% investment tax credit for assets used in the oil and gas, and mining activities in the Atlantic provinces, the Gaspé Peninsula and their associated offshore regions (commonly referred to as the “Atlantic ITC”). Subject to grandfathering, the 10% Atlantic ITC will be reduced to 5% for such assets acquired in 2014 and 2015 and to 0% for assets acquired after 2015. Assets acquired before 2017 as part of a grandfathered phase of a project will be eligible for the 10% Atlantic ITC.

Essentially, a qualified resource property is a property that would have been a qualified property if it had been acquired before March 29, 2012 for use in oil and gas, and mining activities. In particular, a qualified resource property of a taxpayer is a prescribed building or prescribed machinery and equipment acquired by the taxpayer after March 28, 2012 for use by the taxpayer in Canada primarily in oil, gas and mining activities in the Atlantic provinces, the Gaspé Peninsula and their associated offshore regions. Prescribed buildings are described in subsection 4600(1) of the *Income Tax Regulations* and subsection 4600(2) of the *Income Tax Regulations* describes prescribed machinery and equipment. Qualified resource property cannot have been used, or acquired for use or lease, for any purpose whatever before it was acquired by the taxpayer.

Qualified resource property acquired after March 28, 2012 cannot be a qualified property. Therefore, no other ITC rate other than the ITC rate relevant for a qualified resource property can apply in computing the ITC available in respect of such property. No transitional relief other than that described above is available in respect of qualified resource property acquired after March 28, 2012 (i.e., no other transitional relief can be claimed for such property under other relieving provisions that might have previously applied in respect of such property).

The new definition comes into force on March 29, 2012.

“specified percentage”

The definition “specified percentage” in subsection 127(9) sets out the relevant rates at which investment tax credits (ITCs) are earned in different circumstances. The definition is amended in two respects to implement Budget 2012 proposals to phase out the Atlantic ITC and the ITC for pre-production mining expenditures.

New paragraph (*a.1*) of the definition “specified percentage” sets out the Atlantic ITC rate for qualified resource property.

- Subparagraph (*a.1*)(i) provides a 10% rate for qualified resource property acquired after March 28, 2012 and before 2014.
- Subparagraph (*a.1*)(ii) provides a 10% rate for qualified resource property acquired after 2013 and before 2017 if the property is acquired by the taxpayer under a written agreement of purchase and sale entered into by the taxpayer before March 29, 2012, or is acquired as part of a grandfathered phase of a taxpayer’s project. A grandfathered phase is a phase of a project the construction of which was started by, or on behalf of, the taxpayer before March 29, 2012 or the engineering and design work for the construction of which, as evidenced in writing, was started by, or on behalf of, the taxpayer before that date.
- Subparagraph (*a.1*)(iii) provides a 5% rate for qualified resource property acquired in 2014 and 2015, and 0% rate for such property acquired after 2015 and which rates apply in respect of property not otherwise grandfathered.

Paragraph (*j*) of the definition “specified percentage” provides a 10% rate for a pre-production mining expenditure incurred after 2004. Paragraph (*j*) is amended and new paragraph (*k*) is introduced consequential on the introduction of subparagraphs (*a*)(i) and (ii) of the definition “pre-production mining expenditure”.

Paragraph (*j*) of the definition “specified percentage” is amended to provide that an expenditure described in subparagraph (*a*)(i) of the definition “pre-production mining expenditure” will earn a credit at the rate of

- 10%, if the expenditure is incurred before 2013,
- 5%, if the expenditure is incurred in 2013, and
- 0%, if the expenditure is incurred after 2013.

New paragraph (*k*) provides the rates at which an expenditure described in subparagraph (*a*)(ii) of the definition "pre-production mining expenditure" will earn ITCs.

Subparagraph (*k*)(i) provides an ITC rate of 10% for expenditures described in subparagraph (*a*)(ii) incurred before 2014.

Subparagraph (*k*)(ii) provides transitional relief by providing a 10% ITC rate for an expenditure incurred after 2013 and before 2016, if the expenditure is incurred under a written agreement entered into by the taxpayer before March 29, 2012, or as part of the development of a grandfathered mine. A grandfathered mine is a new mine the construction of which was started by, or on behalf of, the taxpayer before March 29, 2012 or the engineering and design work for which, as evidenced in writing, was started by, or on behalf of, the taxpayer before that date.

Subparagraph (*k*)(iii) provides a 7% ITC rate for expenditures incurred in 2014, a 4% ITC rate for expenditures incurred in 2015 and a 0% rate for expenditures incurred after 2015.

For the purposes of new subparagraphs (*a.1*)(ii) and (*k*)(ii) of the definition "specified percentage", neither construction nor engineering and design work include activities such as obtaining permits or regulatory approvals, conducting environmental assessments, community consultations or impact benefit studies, and similar activities.

New paragraph (*a.1*) applies in respect of property acquired after March 28, 2012.

The amendments to paragraph (*j*) and new paragraph (*k*) apply in respect of expenditures incurred after March 28, 2012.

Additions to investment tax credit

ITA
127(10.1)

Subsection 127(10.1) of the Act provides a 15% investment tax credit (ITC) in addition to the basic 20% ITC for certain scientific research and experimental development (SR&ED) expenditures incurred by a Canadian-controlled private corporation (CCPC). As a result, such expenditures qualify for a total ITC of 35%.

Subsection 127(10.1) is amended as a consequence of the amendment to paragraph (*a.1*) of the definition "investment tax credit" in subsection 127(9), which reduces the basic 20% ITC to 15%. The reference to 15% in subsection 127(10.1) is replaced by a reference to 20% in order to maintain the overall 35% ITC rate.

The amendment applies to taxation years that end after 2013. Consistent with the amendment to paragraph (*a.1*) of the definition "investment tax credit" in subsection 127(9), for taxation years that include January 1, 2014, the 5% increase under subsection 127(10.1) is pro-rated based on the number of days in the taxation year that are after 2013.

Interpretation

ITA
127(11)

Subsection 127(11) of the Act provides rules for determining whether a property is a "qualified property" as defined in subsection 127(9). Subsection 127(11) is amended in two respects consequential on the introduction of the new definition "qualified resource property" in subsection 127(9).

First, the preamble is amended to add a reference to the new definition “qualified resource property.” Second, paragraph 127(11)(*b*) is amended to add a reference to paragraph (*a*) of the new definition “qualified resource property.”

These amendments come into force on March 29, 2012.

Time of expenditure and acquisition

ITA
127(11.2)

Subsection 127(11.2) of the Act provides that, for the purposes of claiming an investment tax credit (ITC) under subsection 127(5) or allocating an ITC under subsection 127(7) or (8), property is not considered to have been acquired, and expenditures are not considered to have been made, by a taxpayer until the property is considered to have become “available for use” by the taxpayer. Subsection 127(11.2) is amended in three respects.

The first amendment removes the reference to “certified property”, which is no longer relevant, in paragraph 127(11.2)(*a*) and adds a reference to the new definition “qualified resource property”. The second amendment removes the reference to “first term shared-use-equipment” in paragraph 127(11.2)(*a*). The third amendment removes a reference to subparagraph 37(1)(*b*)(i) in paragraph 127(11.2)(*b*) (it also corrects a reference to “eligible child care space expenditure”).

The first amendment comes into force on March 29, 2012. Consistent with the amendment to the definition “first term shared-use-equipment”, the second amendment comes into force on February 1, 2017. Consistent with the repeal of paragraph 37(1)(*b*), the third amendment applies in respect of expenditures made after 2013.

Adjustments to qualified expenditures

ITA
127(11.5)

Subsection 127(11.5) of the Act reduces, in certain circumstances, qualified expenditures incurred by a taxpayer. Subsection 127(11.5) is amended in two respects.

Paragraph 127(11.5)(*a*) requires that for the purposes of the definition “qualified expenditure” in subsection 127(9), the amount of a qualified expenditure in respect of a capital property is generally to be determined without reference to subsections 13(7.1) and (7.4). Paragraph (*a*), which is amended consequential to the repeal of paragraph 37(1)(*b*), removes the references to subsections 13(7.1) and (7.4).

Paragraph 127(11.5)(*b*) requires that where an expenditure is for first term shared-use-equipment or second term shared-use-equipment only ¼ of the capital cost of the equipment is taken into account and the capital cost of such property is determined without capitalized interest being added to the capital cost under section 21. Subsection 127(11.5) is amended to repeal paragraph (*b*) consequential on the amendment of the definition “first term shared-use-equipment”.

Consistent with the repeal of paragraph 37(1)(*b*), the amendment to paragraph 127(11.5)(*a*) applies in respect of expenditures made after 2013. Consistent with the amendment to the definition “first term shared-use-equipment”, the amendment to paragraph 127(11.5)(*b*) comes into force on February 1, 2017.

Non-arm’s length costs

ITA
127(11.6)

Subsection 127(11.6) of the Act provides rules for determining expenditures for the purposes of subsection 127(11.5) in respect of purchases of goods and services acquired from non-arm's length parties. Consequential on the repeal of paragraph 37(1)(*b*), the mid-amble of subsection 127(11.6) and subparagraph 127(11.6)(*d*)(i) are amended by removing the reference to “capital” in the phrase “capital cost to the taxpayer of the property.”

Consistent with the amendment to the definition “first term shared-use-equipment”, these amendments come into force on February 1, 2017.

Interpretation for non-arm’s length costs

ITA
127(11.8)

Paragraph 127(11.8)(*c*) of the Act provides that the leasing of a property is considered to be the rendering of service for certain purposes. Consistent with the repeal of subparagraph 37(1)(*b*) and the amendments to paragraph 37(8)(*d*), paragraph 127(11.8)(*c*) is repealed.

This amendment applies in respect of expenditures made after 2013.

Certain non-arm’s length transfers

ITA
127(33)

Subsections 127(33) to (35) of the Act apply where a non-arm’s length transfer of property to another taxpayer would otherwise trigger the scientific research and experimental development (SR&ED) investment tax credit (ITC) recapture provisions. Subsection 127(33) provides that the SR&ED ITC recapture provisions do not apply to a taxpayer who disposes of SR&ED property to a non-arm’s length purchaser if the purchaser continues to use the property all or substantially all for SR&ED.

Subsection 127(33) is amended to ensure that notwithstanding the repeal of paragraph 37(1)(*b*) and subclauses 37(8)(*a*)(ii)(A)(III) and (B)(III), the non-application of the recapture rules will remain in effect for non-arm’s length transfers of SR&ED property.

This amendment comes into force on March 29, 2012.

Clause 28

Refundable investment tax credit

ITA
127.1

Section 127.1 of the Act provides for the refundability of investment tax credits (ITCs) under certain circumstances. A qualifying corporation may be eligible for either a 40% or 100% refund for its ITCs depending on the nature of the expenditures.

Definitions

ITA
127.1(2)

Subsection 127.1(2) of the Act sets out definitions relevant for the purposes of section 127.1.

The definition “refundable investment tax credit” defines the portion of investment tax credits (ITCs) that are refundable in a taxation year of a taxpayer that are earned by the taxpayer in respect of a qualified expenditure as defined in subsection 127(9).

Consequential on the repeal of paragraph 37(1)(*b*) and the amendments to paragraph 37(8)(*d*), subparagraph (*f*)(i) of the definition “refundable investment tax credit” is amended to remove the phrase “(other than expenditures of a capital nature)”.

Consistent with the amendment to the definition “first term shared-use-equipment”, this amendment comes into force on February 1, 2017.

Addition to refundable investment tax credit

ITA
127.1(2.01)

Subsection 127(2.01) of the Act provides for the refundability of certain investment tax credits (ITCs) earned by a Canadian-controlled private corporation (CCPC) that is neither a qualifying corporation nor an excluded corporation as defined in subsection 127.1(2).

For a CCPC (other than a qualifying corporation or an excluded corporation) the rate of refund of the 35% ITC is 100% for SR&ED expenditures of a current nature and 40% for SR&ED expenditures of a capital nature.

Consequential on the repeal of paragraph 37(1)(*b*) and the amendments to paragraph 37(8)(*d*), subsection 127.1(2.01) is amended by replacing its paragraphs (*a*) and (*b*) with its existing paragraphs (*c*) and (*d*) (and by repealing paragraphs (*c*) and (*d*)).

Consistent with the amendment to the definition "first term shared-use-equipment", these amendments come into force on February 1, 2017.

Clause 29

Bankruptcy of an individual

ITA
128(2)(*d.1*)

Paragraph 128(2)(*d.1*) of the Act applies where an individual becomes bankrupt in a calendar year and consequently has two taxation years ending in that year. Paragraph 128(2)(*d.1*) modifies the maximum deductions that may be claimed by the individual under subsections 146(5) and (5.1) in respect of RRSP contributions so that the limits applicable in the second taxation year are reduced by contributions deducted in the first taxation year.

Paragraph 128(2)(*d.1*) is amended, consequential on the introduction of section 147.5 pertaining to pooled registered pension plans (PRPPs), and related amendments to subsections 146(5) and (5.1), to ensure that the total employer contributions made in the year to a PRPP in respect of the individual are taken into account in computing a bankrupt individual's RRSP deduction limit under these special rules, as is the case under the general rules.

For further information regarding PRPPs, please see the commentary on section 147.5

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 30

Foreign affiliate dumping – immigrating corporation

ITA
128.1(1)(*c.3*)

New paragraph 128.1(1)(*c.3*) of the Act is added in order to deter certain corporate immigrations that could otherwise be used as substitutes for transactions that are addressed by the foreign affiliate dumping rules in new section 212.3.

Paragraph 128.1(1)(*c.3*) can cause a deemed dividend and/or a paid-up capital reduction to occur in circumstances where a non-resident corporation immigrates to Canada, the immigrating company is controlled by another non-resident and the immigrating company owns shares of a non-resident company (which could include the foreign parent) that becomes a foreign affiliate of the immigrating company either immediately after the immigration or as part of a series of transactions or events that includes the immigration. In these circumstances, the immigration could otherwise lead to a result similar to that which the foreign affiliate dumping rules in new section 212.3 are aimed at preventing.

For the purposes of paragraph 128.1(1)(*c.3*), the look-through rules in subsections 93.1(1) and 212.3(25) apply where one or more partnerships are in the ownership structure. As well, the "multiple control" rule in paragraph 212.3(15)(*a*) applies so that, generally, only one non-resident corporation is considered to control the immigrating company.

New paragraph 128.1(1)(*c.3*) applies in respect of corporations that become resident in Canada after March 28, 2012.

Example 1

Assumptions

- *NR Co 1 owns all the shares of NR Co 2.*
- *NR Co 2 owns all the shares of NR Co 3.*
- *NR Co 2 becomes resident in Canada on May 1, 2012.*
- *Immediately before the immigration, all companies are non-residents of Canada, have a fair market value (FMV) of $100, have a single class of shares and have no debt obligations outstanding.*
- *NR Co 2 has paid-up capital (PUC) of $100 as result of the immigration.*

Analysis

- *NR Co 2 will have achieved a foreign affiliate "dump" as NR Co 3 will become a foreign affiliate of NR Co 2 upon the immigration.*
- *Subparagraph 128.1(1)(c.3)(i) will apply to reduce NR Co 2's PUC by $100, based on the FMV of the NR Co 3 shares at the time of immigration.*

Example 2

Assumptions

- *Same as in Example 1, except that NR Co 2 has debt of $50 outstanding at the time of immigration and the FMV of the shares of NR Co 3 is $150.*

Analysis

- *In addition to the PUC grind set out in Example 1, NR Co 1 would be subject to a deemed dividend of $50 under subparagraph 128.1(1)(c.3)(ii) – based on the excess of the FMV ($150) of the NR Co 3 shares over the amount of the PUC reduction ($100) under subparagraph 128.1(1)(c.3)(i).*

Paid-up capital adjustment

ITA
128.1(3)

Subsection 128.1(3) of the Act ensures that the adjustment to paid-up capital under subsection 128.1(2) does not provide an inappropriate result where, because of a share redemption, acquisition, or cancellation or a reduction of paid-up capital, subsection 84(3), (4) or (4.1) subsequently treats the corporation as having paid a dividend on the shares to which the paid-up capital reduction relates. Similar rules exist in various other provisions of the Act that adjust paid-up capital – see for example paragraph 85(2.1)(*b*) and subsection 212.1(2).

Subsection 128.1(3) is split into two paragraphs. New paragraph 128.1(3)(*a*) contains the existing rule, as modified to modernize its language, and new paragraph 128.1(3)(*b*) introduces a similar rule in respect of paid-up capital reductions under the new foreign affiliate dumping rule in paragraph 128.1(1)(*c.3*).

This amendment comes into force on March 29, 2012.

Clause 31

Rules related to segregated funds

ITA
138.1(7)

Section 138.1 of the Act sets out rules that apply in respect of life insurers' "segregated fund" policies. Subsection 138.1(7) ensures that where a segregated fund policy is issued as a registered retirement savings plan, registered retirement income fund or tax-free savings account, or issued under a registered pension plan, the policyholder will not be required to include in income those amounts which are deemed to become payable out of the income of the related segregated fund trust to the policyholder under subsection 138.1(1).

Subsection 138.1(7) is amended, consequential on the introduction of section 147.5 pertaining to pooled registered pension plans (PRPPs), to extend its application to a segregated fund policy that is issued under a PRPP. This will ensure that deemed payments under subsection 138.1(1) in respect of such a segregated fund policy will not give rise to income in the hands of the policyholder.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 32

Registered retirement savings plans

ITA
146(1)

Subsection 146(1) of the Act defines a number of terms that apply for the purposes of the rules in section 146 of the Act that apply to registered retirement savings plans (RRSPs).

"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 one year to use in future years. An individual's unused RRSP deduction room at the end of a year is generally defined to be the amount determined by the formula A + B + R – (C + D). Variable D reduces an individual's unused RRSP deduction room by the RRSP contributions deducted by the individual in computing his or her income for the year.

As a consequence of the introduction of pooled registered pension plans (PRPPs) and the income tax rules to accommodate them, the description of D in the definition "unused RRSP deduction room" is amended to add new subparagraphs (iii) and (iv).

New subparagraph (iii) will reduce an individual's unused RRSP deduction room by the amount of contributions made by an employer in the year to the individual's account under a PRPP. Pursuant to a concurrent amendment to subsection 146(5), an employer's contributions to an individual's PRPP account in a year also reduce the deductible contributions that the individual can make in the year to an RRSP or PRPP.

New subparagraph (iv) applies where an individual contributes an exempt-income contribution amount (as defined in subsection 147.5(1)) to a PRPP in a taxation year and the amount exceeds the individual's unused non-deductible PRPP room at the end of the prior year. That excess amount will reduce the individual's unused RRSP deduction room at the end of the year. If a PRPP member has no unused RRSP deduction room for a year in which an excess amount described above is contributed to the PRPP, then the excess amount will generally be subject to over-contribution taxes under Part X.1 of the Act.

For more information, please see the related commentary on amendments to paragraphs 146(5)(*a*) and (*b*), the commentary on new subsections 147.5(31) to (34) pertaining to the participation of Indians (as defined in the *Indian Act*) in PRPPs and the commentary on the new definitions “exempt-income contribution amount” and “unused non-deductible PRPP room” in subsection 147.5(1).

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

ITA
146(1.1)

Certain tax provisions apply in relation to the treatment of retirement savings on the death of an individual in situations where a recipient of the savings is a financially dependent child or grandchild of the deceased individual. Subsection 146(1.1) of the Act sets out a rebuttable presumption that a child or grandchild of a deceased RRSP annuitant is not financially dependent on the deceased if the income of the child or grandchild exceeds the amount specified in that subsection.

Subsection 146(1.1) is amended, consequential on the introduction of section 147.5 pertaining to pooled registered pension plans (PRPPs), so that the rebuttable presumption in that subsection also applies for the purposes of section 147.5. For example, the rebuttable presumption in subsection 146(1.1) will now apply for the purposes of

- the definition “qualifying survivor” (in subsection 147.5(1)) of a deceased PRPP member, which includes a child or grandchild who was financially dependent on the member for support; and
- clause 60(*l*)(v)(B.01), which permits a rollover of a lump sum death benefit paid from a deceased PRPP member’s account to a child or grandchild who was financially dependent on the member for support by reason of mental or physical infirmity.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

ITA
146(5)

Subsection 146(5) of the Act provides that an individual may deduct in computing his or her income for a taxation year an amount not exceeding the lesser of two amounts. The first amount, determined under paragraph 146(5)(*a*), is generally the individual’s undeducted RRSP contributions made on or before the 60th day of the year following the taxation year. The second amount, determined under paragraph 146(5)(*b*), is the individual’s RRSP deduction limit for the year.

Paragraph 146(5)(*a*) is amended, consequential on the introduction of new section 147.5 pertaining to pooled registered pension plans (PRPPs), to ensure that exempt-income contribution amounts (as defined in subsection 147.5(1), contributed by an individual to a PRPP may not be deducted in computing the member’s taxable income for any taxation year. In view of the non-deductibility of these contributions, it is expected that payments from a PRPP, up to an amount equal to the total of the exempt-income contribution amounts will not be required to be included in computing the income of the recipient. For more information, see the related commentary on new subsections 147.5(31) to (34) pertaining to the participation of Indians (as defined in the *Indian Act*) in PRPPs and the commentary on the new definition “exempt-income contribution amount” in subsection 147.5(1).

Paragraph 146(5)(*b*) is amended, also consequential on the introduction of new section 147.5 pertaining to PRPPs, so that an employer’s contributions in a year to an individual’s PRPP account will reduce the amount of deductible contributions that the individual can make in that same year to an RRSP or PRPP.

The impact of an employer's contributions to PRPPs on the RRSP room of its employees is not similar to the "pension adjustment" mechanism that applies to employer contributions to a money purchase provision (as defined in subsection 147.1(1)) of a registered pension plan (RPP). Under the RPP rules, a pension adjustment generated from contributions in respect of an individual (i.e., the employee) for a particular year reduces the individual's "RRSP deduction limit" and "unused RRSP deduction room" for the year following the year in which the employer contributions are made.

In the case of a PRPP, an employer's contributions to an individual's PRPP account in a taxation year will immediately reduce the individual's ability to make deductible RRSP contributions under subsection 146(5). New subsection 147.5(11) deems an individual's contributions to a PRPP in a taxation year to be premiums paid by the individual to an RRSP of the individual for various purposes of the Act, including subsection 146(5). As a result, PRPP contributions made to an individual's PRPP account in a year will immediately reduce the individual's ability to make deductible RRSP contributions in that same year.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

ITA
146(5.1)(*b*)

Subsection 146(5.1) of the Act provides that an individual may deduct in computing his or her income for a taxation year an amount not exceeding the lesser of two amounts, described in paragraphs 146(5.1)(*a*) and 146(5.1)(*b*) respectively. The first amount (paragraph 146(5.1)(*a*)) is generally the individual's undeducted RRSP contributions made in respect of the taxation year to RRSPs under which the individual's spouse is the annuitant. The second amount (paragraph 146(5.1)(*b*)) is the individual's RRSP deduction limit for the taxation year, minus the amount deducted by the individual for the year under subsection 146(5) with respect to RRSPs under which the individual is the annuitant. In other words, an individual may deduct contributions to his or her spouse's RRSP but only if the individual him or herself has sufficient RRSP room.

Subsection 146(5.1) is amended, consequential on the introduction of section 147.5 pertaining to PRPPs, so that an employer's contributions to an individual's PRPP account in a taxation year will reduce the individual's ability to make deductible RRSP contributions under subsection 146(5). Specifically, paragraph 146(5.1)(*b*) is amended so that the second amount noted above will be further reduced by the total of all employer contributions made in the year to a PRPP in respect the taxpayer.

New subsection 147.5(11) deems an individual's contributions to a PRPP in a taxation year to be premiums paid by the individual to an RRSP of the individual for various purposes of the Act, including subsection 146(5). As a result, in addition to the employer's contributions to the PRPP, an individual's PRPP contributions in a year will also reduce the individual's ability to make deductible RRSP contributions in that same year.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

ITA
146(8.2)(*b*)

Subsection 146(8.2) of the Act is a relieving provision that provides a deduction for certain RRSP and RRIF distributions that are included in computing an individual's income. The deduction is available to the extent that the distributions are made in respect of certain non-deducted RRSP premiums paid by the individual to the individual's RRSP or to a spousal or common-law partner's RRSP. Paragraph 146(8.2)(*b*) specifies that the deduction, which is generally permitted under subsection 146(8.2), does not apply to a withdrawal of RRSP contributions made by way of a direct transfer from a registered pension plan, a deferred profit sharing plan or a specified pension plan (i.e., the Saskatchewan Pension Plan).

Subparagraph 146(8.2)(*b*)(iii) is amended, consequential on the introduction of section 147.5, to specify that the deduction under subsection 146(8.2) will not be allowed in respect of a withdrawal of RRSP contributions made by way of a direct transfer from a PRPP.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

ITA
146(21.2)

Subsection 146(21.2) of the Act applies for various purposes of the Act and *Income Tax Regulations* to deem an individual's account under a specified pension plan (i.e., the Saskatchewan Pension Plan) to be a registered retirement savings plan under which the individual is the annuitant.

Consequential on the introduction of new section 147.5 pertaining to pooled registered pension plans (PRPPs), subsection 146(21.2) is amended to add a reference to new paragraph 147.5(21)(*c*) to permit a PRPP member or a surviving spouse or common-law partner to transfer an entitlement from a PRPP to an account under the Saskatchewan Pension Plan.

For further information regarding PRPPs, please see the commentary on section 147.5.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 33

Registered education savings plan

ITA
146.1

Section 146.1 of the Act sets out various rules applicable to registered education savings plans (RESPs). Budget 2012 announced a number of measures relating to registered disability savings plans (RDSPs), including one to facilitate a tax-deferred transfer or "rollover" of RESP investment income to an RDSP in certain circumstances. The amendments to section 146.1 give effect to this measure.

Definitions

ITA
146.1(1)

Subsection 146.1(1) of the Act defines a number of terms that apply to registered education savings plans. The definition "registered education savings plan" is amended to introduce the acronym "RESP" for drafting convenience and to improve readability. A similar amendment is made in subsection 248(1).

This amendment comes into force on Royal Assent.

Election

ITA
146.1 (1.1) and (1.2)

New subsections 146.1(1.1) and (1.2) of the Act set out the mechanism to permit a rollover of RESP investment income (referred to in the RESP rules as "accumulated income payments") to an RDSP.

In general terms, a subscriber of an RESP that allows accumulated income payments and a holder of an RDSP may jointly elect in prescribed form to transfer an accumulated income payment under the RESP to the RDSP if, at the time of the election, the RESP beneficiary is also the beneficiary under the RDSP and

- the beneficiary is, or will be, unable to pursue post-secondary education because he or she has a severe and prolonged mental impairment; or

- the RESP has been in existence for more than 35 years, or for at least 10 years and each beneficiary under the RESP has attained 21 years of age and is not eligible to receive educational assistance payments.

Under subsection 146.1(1.2), the promoter of the RESP must file the election with the Minister without delay.

In order to facilitate the transfer of accumulated income payments under RESPs to RDSPs without requiring amendments to the specific terms of existing specimen plans and RESPs established using them, or requiring new specimen plans to be prepared to reflect new terms, subsection 146.1(1.2) also suspends the plan condition in paragraph 146.1(2)(*d.1*) and any terms of the RESP required by that paragraph.

Subsections 146.1(1.1) and (1.2) come into force on January 1, 2014.

Plan conditions

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. Paragraph 146.1(2)(*i.1*) requires that a plan that allows accumulated income payments must provide that it will be terminated before March of the year after the year in which the first such payment is made.

Consequential on the introduction of subsection 146.1(1.2), which suspends the plan condition under paragraph 146.1(2)(*d.1*) in respect of RESPs under which an accumulated income payment is transferred on a tax-free basis to an RDSP, paragraph 146.1(2)(*i.1*) is amended to remove the reference to paragraph 146.1(2)(*d.1*). This amendment ensures that plans that allow a rollover to an RDSP have the same termination requirement as plans that allow accumulated income payments. In other words, if RESP investment income is rolled over to an RDSP, the RESP must be terminated before March of the year following the year in which the rollover occurred.

This amendment comes into force on January 1, 2014.

Income inclusion

ITA
146.1(7.1)

Paragraph 146.1(7.1)(*a*) of the Act provides that accumulated income payments received under an RESP by a taxpayer in a taxation year must be included in computing the taxpayer's income for the year. Paragraph 146.1(7.1)(*a*) is amended to exclude accumulated income payments made under subsection 146.1(1.2). This carve out ensures that a transfer of an accumulated income payment to an RDSP occurs on a tax-deferred basis.

This amendment comes into force on January 1, 2014.

Clause 34

Registered retirement income fund

ITA
146.3(2)(*f*)

Paragraph 146.3(2)(*f*) of the Act prohibits a registered retirement income fund (RRIF) from receiving property, other than property transferred from a limited number of listed sources.

Paragraph 146.3(2)(*f*) is amended to add new subparagraph (viii), which adds pooled registered pension plans to the list of registered vehicles from which a RRIF may receive a transfer of property.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

ITA
146.3(14.1)

Subsection 146.3(14.1) of the Act provides for the direct transfer of an amount from an annuitant's RRIF to a money purchase provision of a registered pension plan for the benefit of the annuitant under certain circumstances.

Subsection 146.3(14.1) is amended, consequential on the introduction of section 147.5 pertaining to pooled registered pension plans (PRPPs), to permit a RRIF annuitant to transfer an amount from the RRIF to the annuitant's account under a PRPP.

For further information regarding PRPPs, please see the commentary on new section 147.5.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 35

Registered disability savings plan

ITA
146.4

Budget 2012 announced a number of measures relating to registered disability savings plans (RDSPs). Amendments to section 146.4 of the Act give effect to the measures relating to:

- maximum and minimum withdrawal rules;
- the rollover of registered education savings plan (RESP) investment income;
- the termination of an RDSP following the cessation of eligibility for the disability tax credit (DTC); and
- administrative changes and filing requirements.

Definitions

ITA
146.4(1)

Subsection 146.4(1) of the Act defines a number of terms that apply for the purposes of the rules relating to registered disability savings plans (RDSPs).

"contribution"

The definition "contribution" is relevant for the purposes of several provisions in section 146.4 and Part XI of the Act. Paragraph (*d*) of the definition "contribution" is amended in two respects.

First, it is amended to exclude an accumulated income payment (AIP) made under a registered education savings plan (RESP) to an RDSP under subsection 146.1(1.2), except for certain purposes, similar to the current treatment under paragraph (*d*) of a "specified RDSP payment" (as defined in subsection 60.02(1)).

Second, paragraph (*d*) is amended to expand the purposes for which a specified RDSP payment and an AIP are to be treated as a contribution. Under this amendment, a specified RDSP payment and an AIP made to the RDSP will be a contribution for the purposes of paragraphs 146.4(4)(*f*) to (*h*) and (*n*), as well as paragraph (*b*) of the definition "advantage" in subsection 205(1). This means that specified RDSP payments and AIPs will be subject to the overall RDSP lifetime contribution limit of $200,000, and can only be made in respect of "DTC-eligible individuals" (as defined in subsection 146.4(1)) who are under 60 years old and resident in Canada at the time of the payment (see paragraphs 146.4(4)(*f*) and (*g*)). Specified RDSP payments and AIPs will, under paragraph 146.4(4)(*h*), have to be made either by, or with the consent of, the RDSP holder. Under paragraph 146.4(4)(*n*), specified RDSP payments and AIPs will be treated as private contributions and not as amounts received under the *Canada Disability Savings Act*. Further, specified RDSP payments and AIPs made to an RDSP will not be considered an “advantage” for the purposes of subsection 205(1). As is the case for a specified RDSP payment, an AIP paid to an RDSP will not attract Canada Disability Savings Grants.

These amendments come into force on January 1, 2014.

“holder”

Paragraph (*c*) of the definition “holder” is amended to replace the reference to subparagraph (4)(*n*)(iii) with a reference to subparagraph (4)(*n*)(ii). This amendment is consequential on the renumbering of subparagraph 146.4(4)(*n*)(iii) as subparagraph (4)(*n*)(ii). For further information, see the commentary on paragraphs 146.4(4)(*n*) and (*n.1*).

This amendment comes into force on January 1, 2014.

“registered disability savings plan”

The definition “registered disability savings plan” is amended to introduce the acronym “RDSP” for drafting convenience and to improve readability. A similar amendment is made in subsection 248(1).

This amendment comes into force on Royal Assent.

“specified maximum amount”

Subsection 146.4(1) is amended to introduce a new definition “specified maximum amount” in relation to a disability savings plan. This definition is relevant for the purposes of subparagraph 146.4(4)(*n*)(i), which imposes the maximum annual limit on the amount of disability assistance payments that can be made from an RDSP when the plan is a primarily government-assisted plan (i.e., where the total of all grants and bonds paid under the *Canada Disability Savings Act* in respect of the beneficiary of the plan exceeds the total of all private contributions made in respect of the beneficiary, as described in the opening portion of paragraph 146.4(4)(*n*)).

The new definition “specified maximum amount”, in conjunction with the amendment to paragraph 146.4(4)(*n*), gives effect to the Budget 2012 measure to increase the maximum annual limit for withdrawals from a primarily government-assisted plan to the greater of the amount determined by the lifetime disability assistance payment (LDAP) formula in paragraph 146.4(4)(*l*) and 10% of the fair market value of the RDSP assets at the beginning of the calendar year.

In general terms, consistent with the foregoing, the specified maximum amount in respect of a disability savings plan for a calendar year is the greater of

- the amount determined by the LDAP formula in paragraph 146.4(4)(*l*) in respect of the plan for the calendar year;

and

- 10% of the fair market value of the RDSP assets at the beginning of the calendar year or, if the RDSP is holding a “locked-in” annuity, the sum of 10% of the fair market value of the RDSP assets (other than the annuity contract) and the total amount of periodic payments received by the RDSP trust (or, if the RDSP trust disposed of the right to such payments, an estimate of the payments that the RDSP trust would have received) in the calendar under the annuity.

This amendment comes into force on January 1, 2014.

Specified disability savings plans

ITA
146.4(1.2)

Under the RDSP rules, a specified disability savings plan (SDSP) is, in general terms, an RDSP of a beneficiary who has a shortened life expectancy (as certified by a medical doctor) where the holder of the RDSP has elected to have the RDSP treated as such a plan. An SDSP is not subject to the requirement to repay assistance holdback amounts on early withdrawals. Subsection 146.4(1.2) of the Act describes the circumstances in which a plan will cease to be an SDSP. Subsection 146.4(1.2) is amended in several respects.

Paragraph 146.4(1.2)(*b*) is amended consequential on the introduction of new rules to increase the maximum annual limit for withdrawals from a primarily government-assisted plan (i.e., a plan in which the total of all grants and bonds paid under the *Canada Disability Savings Act* in respect of the beneficiary of the plan exceeds the total of all private contributions made in respect of the beneficiary, as described in the opening portion of paragraph 146.4(4)(*n*)) to the greater of the amount determined by the LDAP formula in paragraph 146.4(4)(*l*) and 10% of the fair market value of the RDSP assets at the beginning of the calendar year. This increase in limits is not extended to plans that are SDSPs. The amendment to paragraph 146.4(1.2)(*b*) therefore preserves the existing maximum annual withdrawal limits applicable to SDSPs.

Paragraph 146.4(1.2)(*c*) is amended in three respects:

- First, existing subparagraph 146.4(1.2)(*c*)(ii) is amended consequential on the introduction of new rules that allow, in certain circumstances, for the transfer of investment income from an RESP to an RDSP on a tax-deferred (or “rollover”) basis. These transfers are treated as contributions to a plan for certain purposes. Consistent with the general rule that contributions cannot be made to a plan while it is an SDSP, the amendment to subparagraph 146.4(1.2)(*c*)(ii) provides that a plan will cease to be an SDSP immediately before the transfer of RESP investment income to the SDSP.
- Second, to improve readability, the rules in existing paragraph 146.4(1.2)(*d*) are being moved to paragraph 146.4(1.2)(*c*). Therefore, subparagraphs 146.4(1.2)(*d*)(i) and (ii) are renumbered as subparagraphs 146.4(1.2)(*c*)(iii) and (iv).
- Third, new subparagraph 146.4(1.2)(*c*)(v) is added consequential on the introduction of new rules applicable to a plan when the beneficiary no longer has severe and prolonged impairments (i.e., the beneficiary becomes ineligible for the disability tax credit - “DTC-ineligible”). In rare circumstances, a beneficiary under an SDSP may recover to the point of becoming DTC-ineligible, in which case the beneficiary should be subject to the same rules that apply to other RDSP beneficiaries who have become DTC-ineligible. New subparagraph 146.4(1.2)(*c*)(v) effectively prohibits a beneficiary under an SDSP who becomes DTC-ineligible from obtaining unintended results.

Paragraphs 146.4(1.2) (*e*) and (*f*) are replaced by new paragraph 146.4(1.2)(*d*). This amendment is consequential on the introduction of new paragraph 146.4(4)(*n.1*), which extends to all RDSPs the minimum withdrawal requirement that currently applies to primarily government-assisted plans. In effect, new paragraph 146.4(1.2)(*d*) requires that the total amount of disability assistance payments made from an SDSP in a calendar year be at least equal to the amount determined by the LDAP formula set out in paragraph 146.4(4)(*l*) and that these payments start in the calendar year following the year in which the RDSP became an SDSP, consistent with the requirement in existing paragraph 146.4(1.2)(*e*).

These amendments come into force on January 1, 2014.

Registered status

ITA
146.4(3)

Subsection 146.4(3) of the Act deems a disability savings plan never to have been a registered disability savings plan if the conditions set out in that subsection are not met.

Subsection 146.4(3) is amended to replace the 60-day and 120-day deadlines imposed under that subsection with requirements that issuers take action “without delay”. This change is intended to provide greater flexibility in dealing with situations such as incorrectly completed forms or other circumstances where the fixed time frames may not have provided adequate time for compliance.

Under existing paragraph 146.4(3)(*a*), an issuer is required, within 60 days of the establishment of a plan, to notify the specified Minister (i.e., the Minister of Human Resources and Skills Development) of the establishment of the plan. Paragraph 146.4(3)(*a*) is amended to instead require an issuer to notify without delay the specified Minister of the establishment of a plan. The issuer is still required to provide the notification in prescribed form containing prescribed information.

If the beneficiary of a plan is, at the time the plan is established, the beneficiary under another plan, paragraph 146.4(3)(*b*) requires that other plan to be terminated within 120 days of the new plan being entered into (or such later day as the specified Minister considers reasonable in the circumstances). Paragraph 146.4(3)(*b*) is amended to require that the other plan instead be terminated without delay.

These amendments come into force on Royal Assent.

Plan conditions

ITA
146.4(4)

Subsection 146.4(4) of the Act sets out registration conditions applicable to RDSPs. Subsection 146.4(4) is amended in several respects.

Maximum and minimum limits

ITA
146.4(4)(*n*) and (*n.1*)

Paragraph 146.4(4)(*n*) of the Act imposes limits on the amount of disability assistance payments that can be made in a calendar year from an RDSP when the plan is a primarily government-assisted plan (i.e., where the total of all grants and bonds paid under the *Canada Disability Savings Act* in respect of the beneficiary of the plan exceeds the total of all private contributions made in respect of the beneficiary, as described in the opening portion of paragraph 146.4(4)(*n*)). Primarily government-assisted plans are subject to the maximum annual withdrawal limit set out in subparagraph 146.4(4)(*n*)(i) and, in respect of an RDSP beneficiary who has attained 59 years of age, the minimum annual withdrawal requirement set out in subparagraph 146.4(4)(*n*)(ii).

Paragraph 146.4(4)(*n*) is amended in two respects. First, subparagraph 146.4(4)(*n*)(i) is amended to establish the maximum annual withdrawal limit at the “specified maximum amount”, as defined in subsection 146.4(1). Second, the existing plan condition in subparagraph 146.4(4)(*n*)(ii) related to the requirement for minimum annual withdrawals after age 59 is moved to new paragraph 146.4(4)(*n.1*) (and, as a result, subparagraph 146.4(4)(*n*)(iii) is renumbered as subparagraph 146.4(4)(*n*)(ii)).

The amendment to subparagraph 146.4(4)(*n*)(i), in conjunction with the new definition “specified maximum amount” in subsection 146.4(1), gives effect to the Budget 2012 measure to increase the maximum annual limit for withdrawals from a primarily government-assisted plan to the greater of the amount determined by the LDAP formula in paragraph 146.4(4)(*l*) and 10% of the fair market value of the RDSP assets at the beginning of the calendar year. For further information, see the commentary on the definition “specified maximum amount” in subsection 146.4(1).

Moving the plan condition in existing subparagraph 146.4(4)(*n*)(ii) to new paragraph 146.4(4)(*n.1*) and making the condition applicable to all plans gives effect to the Budget 2012 measure to extend to all RDSPs the minimum annual withdrawal requirement that currently applies to primarily government-assisted plans. This amendment therefore means that, for years after an RDSP beneficiary attains 59 years of age, the RDSP must provide for minimum annual withdrawals equal to the amount determined by the LDAP formula in paragraph 146.4(4)(*l*).

These amendments come into force on January 1, 2014.

Transfers

ITA
146.4(4)(*o*)

Paragraph 146.4(4)(*o*) of the Act requires that the terms of an RDSP must provide that the issuer shall, at the direction of the holders of the plan, transfer all the property held by the plan trust (or an amount equal to its value) to another RDSP of the beneficiary, together with all information in the issuer's possession that may reasonably be considered necessary for the new plan to comply with the requirements of the Act and with any conditions and obligations imposed under the *Canada Disability Savings Act*.

To reduce the administrative burden for issuers, Budget 2012 conferred on Human Resources and Skills Development Canada (rather than the issuer of the RDSP) the responsibility for providing this information to the issuer of the new RDSP when an RDSP transfer occurs.

Paragraph 146.4(4)(*o*) is amended to require the issuer of the RDSP to provide to the issuer of the new RDSP only that information which the specified Minister (i.e., the Minister of Human Resources and Skills Development) has not provided to the issuer of the new RDSP when an RDSP transfer occurs. A similar amendment is made to paragraph 146.4(8)(*c*).

This amendment comes into force on Royal Assent.

Plan termination on cessation of eligibility for the disability tax credit (DTC)

ITA
146.4(4)(*p*) & 146.4(4.1) to (4.2)

Paragraph 146.4(4)(*p*) of the Act requires the wind-up of an RDSP by the end of the calendar year following the earlier of the calendar year in which the beneficiary dies and the first calendar year throughout which the beneficiary has no severe and prolonged impairments with the effects described in paragraph 118.3(1)(*a.1*) (i.e., the beneficiary becomes DTC-ineligible).

To reduce the administrative burden on beneficiaries who might, due to the nature of their condition, become temporarily DTC-ineligible and to ensure greater continuity in their long-term savings, Budget 2012 introduced a measure to enable the holder of an RDSP to elect to keep the RDSP open for up to five years in circumstances where the beneficiary has become DTC-ineligible.

To give effect to this measure, new subsections 146.4(4.1) and (4.2) are introduced and subparagraph 146.4(4)(*p*)(ii) is amended.

New subsection 146.4(4.1) sets out the conditions that a holder of an RDSP must meet in order to make an election to keep the RDSP open in respect of a beneficiary who is DTC-ineligible for a particular taxation year. Specifically,

- the beneficiary must have been DTC-eligible for the year immediately preceding the particular taxation year;
- a medical doctor must certify in writing that the nature of the beneficiary's condition is such that, in the doctor's professional opinion, the beneficiary is likely to become DTC-eligible again;
- the holder must make the election in a manner and format acceptable to the specified Minister (i.e., the Minister of Human Resources and Skills Development) before the end of the year immediately following the particular taxation year and provide the election and medical certification in respect of the beneficiary to the issuer of the plan; and
- the issuer must notify the specified Minister of the election in a manner and format acceptable to the specified Minister.

New subsection 146.4(4.2) provides that an election made under subsection 146.4(4.1) ceases to be valid at the time that is the earlier of the beginning of the first taxation year for which the beneficiary is again DTC-eligible and the end of the fourth taxation year following the particular taxation year referred to in subsection 146.4(4.1). This means that

- if the beneficiary re-qualifies for the DTC within five years, the plan would revert to being a regular RDSP and the usual rules would apply commencing with the taxation year for which the beneficiary is DTC-eligible. The election would cease to be valid at the beginning of that year; and
- if the beneficiary does not re-qualify for the DTC within five years, the election would cease to be valid at the end of the fifth taxation year for which the beneficiary is DTC-ineligible and the plan would need to be wound up by the end of the year following that year.

Subparagraph 146.4(4)(*p*)(ii) is amended consequential on these new rules:

- If an election to keep the RDSP open is made under subsection 146.4(4.1), clause 146.4(4)(*p*)(ii)(A) requires that the plan terms provide for the wind-up of the plan by the end of the calendar year following the first year that includes the time that the election ceases, because of paragraph 146.4(4.2)(*b*), to be valid. In other words, because the beneficiary did not re-qualify for the DTC within five years, the plan would have to be wound up by the end of the calendar year following the fifth taxation year for which the beneficiary was DTC-ineligible.
- In any other case, clause 146.4(4)(*p*)(ii)(B) requires that the plan terms provide for the wind-up of the plan by the end of the calendar year following the first calendar year throughout which the beneficiary is DTC-ineligible.

New subsections 146.4(4.1) and (4.2) and the amendment to subparagraph 146.4(4)(*p*)(ii) come into force on January 1, 2014. However, new subsection 146.4(4.3) provides a special transitional rule for a plan the beneficiary of which is DTC-ineligible for the 2011 or 2012 taxation year and which has not been terminated. For further information, see the commentary below on subsection 146.4(4.3).

Transitional rule

ITA
146.4(4.3)

New subsection 146.4(4.3) of the Act contains a special transitional rule for a plan the beneficiary of which is DTC-ineligible for the 2011 or 2012 taxation year and which has not been terminated.

Under new subsection 146.4(4.3), if 2011 or 2012 is the first calendar year throughout which the beneficiary of a plan is DTC-ineligible and the plan has not been terminated, unless an election is made under subsection 146.4(4.1) the plan must be terminated by the end of 2014. In order to make this transitional rule available to plans without requiring amendments to the specific terms of existing specimen plans and plans established using them, or requiring new specimen plans to be prepared to reflect new terms, subsection 146.4(4.3) also suspends the plan condition in paragraph 146.4(4)(*p*)(ii) as it read on March 28, 2012 and any terms of the plan required by that paragraph.

For further information on subsection 146.4(4.1), see the commentary on paragraph 146.4(4)(*p*).

Subsection 146.4(4.3) comes into force on March 29, 2012.

Transfers

ITA
146.4(8)

Subsection 146.4(8) provides rules governing transfers from one RDSP of a beneficiary to another. Paragraph 146.4(8)(*c*) requires that the issuer of the RDSP provide the issuer of the other RDSP with all information in its possession that may reasonably be considered necessary for the other RDSP to comply with the requirements of the Act and with any conditions and obligations imposed under the *Canada Disability Savings Act*.

To reduce the administrative burden for issuers, Budget 2012 conferred on Human Resources and Skills Development Canada, rather than the issuer of the RDSP, the responsibility for providing this information to the issuer of the other RDSP when an RDSP transfer occurs.

Paragraph 146.4(8)(*c*) is amended to require the issuer of the RDSP to provide to the issuer of the new RDSP only that information which the specified Minister (i.e., the Minister of Human Resources and Skills Development) has not provided to the issuer of the new RDSP when an RDSP transfer occurs. A similar amendment is made to paragraph 146.4(4)(*o*).

This amendment comes into force on Royal Assent.

Clause 36

Pooled registered pension plans

ITA
147.5

New section 147.5 of the Act provides the basic framework of income tax rules that will apply in relation to pooled registered pension plans (PRPPs). In general terms, PRPPs are intended to operate in a manner similar to multi-employer money-purchase registered pension plans, but with certain features drawn from the registered retirement savings plan and registered retirement income fund systems. The overall policy intent of the tax rules is to provide a new option for retirement savings – one that will be especially attractive to smaller employers and to self-employed individuals. Consequently, and in the interests of reducing costs for taxpayers, the rules are intended to be, in some respects, simpler than the existing tax rules for pensions.

New section 147.5, and the related tax rules applicable to PRPPs, will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

ITA
147.5(1)

New subsection 147.5(1) of the Act defines terms that are relevant for the purposes of new subsection 147.5.

"administrator"

An "administrator" of a PRPP is generally defined to be a corporation resident in Canada that has responsibility for the administration of a PRPP and that is authorized under the *Pooled Registered Pension Plans Act* or a similar law of a province to act as a PRPP administrator.

"designated pooled pension plan"

A "designated pooled pension plan" is generally defined to be a pooled pension plan that, at any time in a calendar year, has fewer than 10 participating employers, holds more than half of its property (by fair market value) for employees of a single employer, or has a plan membership that is concentrated with a single employer (i.e., more than 50% of plan members work for a single employer). For this purpose, new subsection 147.5(29) generally deems related employers, as well as various units of trade unions, to be a single employer.

Designated pooled pension plan status, which is anticipated to be fairly unusual, is relevant to the application of new subparagraph 147.5(3)(*e*)(ii), which generally precludes a designated pooled pension plan from holding investments in an employer that participates in the plan.

"exempt earned income"

The definition "exempt earned income" is relevant for the purposes of subsections 147.5(31) to (34), which generally enable Indians (as defined in the *Indian Act*) and their employers to contribute to PRPPs out of or from employment income that would be earned income under subsection 146(1) but for the non-inclusion in income under paragraph 81(1)(*a*) of the Act as it applies with respect to the *Indian Act*. Such income may qualify as exempt earned income for PRPP contribution purposes, provided that the PRPP member reports the amount in prescribed form to the Canada Revenue Agency by the member's filing-due date for the year or by such later date within 3 calendar years as is acceptable to the Minister of National Revenue.

For further information, please see the related commentary on the definitions "exempt-income contribution amount" and "unused non-deductible PRPP room" in this subsection and the commentary on subsections 147.5(31) to (34).

"exempt-income contribution amount"

The definition "exempt-income contribution amount" is relevant for the purposes of subsections 147.5(31) to (34), which generally enable Indians (as defined in the *Indian Act*) and their employers to contribute to PRPPs out of or from the exempt earned income of Indians who are PRPP members. It is defined, in respect of a taxation year, as the total of a taxpayer's PRPP contributions for the year that are not deductible because of subsection 147.5(32), plus amounts designated under subsection 147.5(34) by the taxpayer in prescribed form filed with the Canada Revenue Agency by the taxpayer's filing-due date for the year or such later date within 3 calendar years as is acceptable to the Minister of National Revenue.

For further information, please see the related commentary on the definitions "exempt earned income" and "unused non-deductible PRPP room" in this subsection and the commentary on subsections 147.5(31) to (34).

"member"

A "member" of a pooled pension plan is an individual who holds an account under the plan.

"participating employer"

A "participating employer" is generally defined as an employer who either makes contributions to a PRPP on behalf of its employees, or one who, under a contract with the PRPP's administrator, has set up an arrangement to facilitate employee contributions. This definition is therefore intended to apply to employers who, in effect, offer one or more PRPPs to their employees, but not to an employer who occasionally remits amounts to various PRPPs at the request of an employee.

For example, in 2019 an employer hires Keith, who has been in the workforce for 10 years and has organized his retirement savings through different periods of employment and self-employment in a single PRPP. Keith is working out well, and his employer awards him a $2,000 bonus. Keith asks if the employer could remit this amount directly to his PRPP and the employer agrees. In this case, Keith's employer would not be a participating employer for the purposes of Keith's PRPP.

The definition "participating employer" is relevant to the application of the definition "designated pooled pension plan" and to the related rules in new paragraph 147.5(3)(*c*) and new subparagraph 147.5(3)(*e*)(ii).

"pooled pension plan"

A "pooled pension plan" is generally defined as a plan that has been registered under the *Pooled Registered Pension Plans Act* or a similar law of a province. This concept follows the same basic approach that is found with respect to other plans registered under the Act. Rules in the Act that apply to a plan that either has not yet been registered under the Act or whose registered status has been revoked refer to "pooled pension plans"; as do those rules that apply in situations where a plan may or not be registered. Rules in the Act that apply only to pooled pension plans with registered status under the Act refer to "pooled registered pension plans" or "PRPPs".

"pooled registered pension plan" or "PRPP"

A "pooled registered pension plan" or "PRPP" is a pooled pension plan that has been accepted for registration by the Minister of National Revenue and that registration has not been revoked. Registration conditions for PRPPs are set out in new subsection 147.5(2).

“qualifying annuity”

The term “qualifying annuity” is defined for the purposes of a transfer described in new paragraph 147.5(21)(*c*). A qualifying annuity may be purchased for the benefit of an individual described under new paragraph 147.5(21)(*b*). In that case, PRPP account proceeds used to purchase the annuity will not be included under new subsection 147.5(16) in the income of the person for whom the annuity was acquired. An annuity purchased from a PRPP account is a qualifying annuity if it satisfies the following five conditions:

- the annuity is payable either for the individual’s life or for the joint lives of the individual and his or her spouse or common-law partner (paragraph (*a*));
- payments under the annuity begin by the end of the calendar year in which the individual attains 71 years of age, or the end of the calendar year of acquisition, whichever is later (paragraph (*b*));
- the annuity is payable at least annually and generally in equal installments (subject to permitted variations and increases described in subparagraphs 146(3)(*b*)(iii) to (v) (paragraph (*c*));
- any guarantee period (in relation to early death of the annuitant(s)) does not exceed 15 years and, if the annuitant(s) dies during the guarantee period, any amount payable is commuted into a single payment (paragraph (*d*)); and
- no premiums may be paid under the annuity, other than the payment from the PRPP to acquire the annuity (paragraph (*e*)).

“qualifying survivor”

A “qualifying survivor”, in relation to a deceased PRPP member, is an individual who was, immediately before the member’s death, the spouse or common-law partner of the member, or a child or grandchild of the member who was financially dependent on the member. The determination of whether a child or grandchild is “financially dependent” is subject to the interpretation rule in subsection 146(1.1).

“restricted investment”

A “restricted investment” for a pooled pension plan is, in general terms, an investment in a business in which a plan member has a “significant interest” (as that term is described in new subsection 147.5(30)) or with which a plan member does not deal at arm’s length. This definition is relevant in relation to new subparagraph 147.5(3)(*e*)(i).

“single amount”

A “single amount” paid from a PRPP is any payment that is not a part of a series of periodic payments from the PRPP. This is the same definition as is used in subsection 147.1(1) and is intended to have the same meaning.

“successor member”

A “successor member” means, in general terms, a surviving spouse or common-law partner who assumes all of the rights in respect of the PRPP account of the original plan member on that member’s death. This concept, similar to a “successor holder” of a tax-free savings account, a successor annuitant of a registered retirement income fund (RRIF) or a designated beneficiary of a life insurance policy, will enable a surviving spouse or common-law partner who has obtained all of the member’s rights to benefits under the PRPP to assume the deceased member’s position in relation to the PRPP account without any further tax consequences related to the death of the member. Where this definition applies, new subsection 147.5(15) will govern the transfer of the rights under the plan and the other PRPP rules relating to succession will not apply.

“unused non-deductible PRPP room”

The definition “unused non-deductible PRPP room” is relevant for the purposes of subsections 147.5(31) to (34), which generally enable Indians (as defined in the *Indian Act*) and their employers to contribute to PRPPs out of or from the exempt earned income of Indians who are PRPP members. Specifically, a taxpayer’s unused non-deductible PRPP room at the end of a taxation year is determined by the formula A – B. Variable A is the amount that would be the taxpayer's unused RRSP deduction room at the end of the year if exempt earned income were included in the calculation of earned income under subsection 146(1) and the taxpayer's exempt-income contribution amounts were deductible under subsection 146(5) in computing the taxpayer's income for the year. Variable B is the taxpayer's unused RRSP deduction room as defined in subsection 146(1) at the end of the year.

For further information, please see the related commentary on the definitions "exempt earned income" and "exempt-income contribution amount" in this subsection and the commentary on subsections 147.5(31) to (34).

ITA
147.5(2)

New subsection 147.5(2) of the Act sets out the conditions for registration of a PRPP. The introductory portion of subsection 147.5(2) requires that the Minister of National Revenue not accept a pooled pension plan for registration unless the application has been made in the prescribed manner (that is, in the manner and form determined by the Minister) and the Minister is satisfied that the plan meets all the registration conditions set out in the subsection.

New paragraph 147.5(2)(*a*) requires that the main purpose of a PRPP be to accept and invest contributions for the purpose of providing retirement income to the PRPP's members, subject to the limits (e.g., contribution limits) and requirements (e.g., investment restrictions) applicable to PRPPs under the Act.

New paragraph 147.5(2)(*b*) requires that a single and separate account be maintained for each PRPP member under the member's Social Insurance Number, that each account be credited with contributions made to the plan in respect of the member and investment earnings allocated to the member, and that each account be charged with all payments and distributions made out of the account in respect of the member.

New paragraph 147.5(2)(*c*) requires that the only benefits provided to any member of a PRPP be those that can be funded out of the member's account (similar to the rules that apply to money purchase accounts under registered pension plans). For further information, please see the commentary on new subsections 147.5(5) and (21), which relate to permissible benefits and transfers out of PRPPs.

New paragraph 147.5(2)(*d*) requires an annual (or more frequent) allocation of PRPP investment earnings to member accounts and that those earnings be allocated on a reasonable basis.

New paragraph 147.5(2)(*e*) requires that all property held in connection with a PRPP be held under an arrangement that is acceptable to the Minister of National Revenue. It is anticipated that the Canada Revenue Agency will outline its requirements for accepting a trust, an insurance contract or other funding arrangements for purposes of registering a PRPP, and that these requirements will be generally similar to the Minister's existing requirements with respect to "funding media" for registered pension plans.

New paragraph 147.5(2)(*f*) requires a PRPP to include a stipulation that no right of a person under the PRPP is capable of being assigned, charged, anticipated, given as security or surrendered. However, the paragraph does allow an assignment (i.e., of all or a portion of a member's account) to a current or former spouse or common-law partner pursuant to a court order or written agreement on the breakdown of marriage or common-law partnership or an assignment by the legal representative of a deceased individual on the distribution of the individual's estate.

New paragraph 147.5(2)(*g*) requires that all contributions made to a member's account vest immediately and indefeasibly. This requirement is consistent with a requirement in the *Pooled Registered Pension Plans Act* and is included in order to avoid the complexities inherent in "pension adjustment reversal" rules that otherwise apply to registered pension plans. For example, if employer contributions did not vest immediately but instead could be re-distributed to the accounts of other members or be returned to the employer where an employee that was a plan member left employment before the end of a two-year period, it would be appropriate to have a mechanism that required the employer to calculate how much RRSP room should be restored to the member.

New paragraph 147.5(2)(*h*) requires that a PRPP permit a member of the PRPP to withdraw an amount from his or her member's account if tax would otherwise be payable by the member on that amount under Part X.1 of the Act.

Paragraph 147.5(2)(*i*) requires that any amount payable from a member's account after the death of the member be paid as soon as practicable after the member's death.

Paragraph 147.5(2)(*j*) requires that there be no reason to expect (e.g., based on a review of the application for registration) that the PRPP may become a revocable plan. See the commentary on subsections 147.5(3) and (4) – those subsections list various circumstances under which a PRPP becomes a revocable plan.

Paragraph 147.5(2)(*k*) allows additional registration conditions to be prescribed by regulation. No such additional conditions are currently contemplated.

ITA
147.5(3)

New subsection 147.5(3) of the Act sets out the circumstances under which the registered status of a PRPP becomes revocable by the Minister of National Revenue (i.e., the PRPP becomes a revocable plan).

Under new paragraph 147.5(3)(*a*), a PRPP becomes a revocable plan if it accepts a contribution in respect of a member that is not made by the member, made by an employer or former employer of the member, or transferred to the PRPP on behalf of the member under one of the listed transfer provisions.

Under new paragraph 147.5(3)(*b*), a PRPP becomes a revocable plan if it accepts a contribution in respect of a member after the year in which the member turns 71 years of age (other than one transferred to the PRPP on behalf of the member under one of the listed transfer provisions).

Under new paragraph 147.5(3)(*c*), a PRPP becomes a revocable plan if a participating employer makes contributions to a PRPP in respect of a plan member that exceed the RRSP dollar limit for the year, except where the member has given a direction for the employer to contribute a larger amount. Since the main method of ensuring that retirement savings contribution limits are respected in relation to PRPPs is the application of the RRSP over-contribution rules in Part X.1 of the Act, which rules apply in relation to individual members, the RRSP dollar limit has been selected as a reasonable safeguard against member over-contributions that would be subject to Part X.1. By giving a direction, an individual who knows that he or she has unused RRSP deduction room that is greater than the year's RRSP dollar limit, could, for example, direct that a large bonus payable by an employer be contributed by the employer to the member's PRPP account.

Under new paragraph 147.5(3)(*d*), a PRPP becomes a revocable plan if certain distributions are made from the plan. The distributions that cause a PRPP to become revocable are any distributions, other than

- payments of benefits described in subsection 147.5(5) (including any single amount payment that is transferred in accordance with subsection 147.5(21)), or
- a return of contributions to correct reasonable errors in amounts contributed, to avoid revocation of plan registration, to permit the member to reduce the amount of tax that would otherwise be payable under Part X.1 or to comply with any requirement under the Act.

For further information, please see the commentary on paragraph 147.5(2)(*h*) and subsections 147.5(5), (21) and (22).

New paragraphs 147.5(3)(*e*) and (*f*) impose basic restrictions on the property that a PRPP may hold. These investment restrictions are intended to prevent certain types of tax planning arrangements.

Under new subparagraph 147.5(3)(*e*)(i), an administrator is precluded from holding a property that the administrator knew or ought to have known was a "restricted investment". This rule is intended to prevent a plan administrator from participating in an arrangement whereby plan members contribute, or cause the PRPP to acquire, interests in a member's business or professional practice, with a view to streaming income to the

PRPP. Subparagraph 147.5(3)(*e*)(i) is not meant to impose an obligation on administrators to make an exhaustive inquiry into the possible connections between a particular plan member and a given investment opportunity; but rather to prevent administrators from participating in arrangements that could be used to circumvent PRPP contribution limits or, in the case of older individuals, to systematically reduce the value of their PRPP accounts in order to avoid or reduce required PRPP withdrawals in retirement.

Example One – Ordinary Course Investing by PRPP

Tom is a graphic designer and has been saving for his retirement by contributing to a PRPP. At the end of 2020, Tom's PRPP savings are $35,000. In 2021, Tom marries Jane. Jane is the daughter of Ed and Sara, a wealthy couple who together directly hold a "significant interest" (i.e., more than 10% of a class of shares) in Pubco. Because of Ed and Sara's shareholdings, Tom and Jane are themselves considered to have a "significant interest" in Pubco. Tom's PRPP holds assets of over $500 million on behalf of thousands of Canadians. Among those assets, Tom's PRPP holds 1% of a class of shares of Pubco that trades publicly.

Although Jane has independent wealth, she also works as a physiotherapist in a small clinic, which has begun offering a PRPP to its employees. Jane has become a member of this PRPP. Jane's PRPP has a bond focus and holds Pubco bonds among its investments.

In these circumstances, the administrators of Tom's and Jane's PRPPs could not reasonably be expected to know about Tom's or Jane's connection to Pubco, nor that the PRPP's holdings of Pubco are restricted investments. Situations like this are meant to be accommodated and would not be considered to violate the rule in new subparagraph 147.5(3)(e)(i). As a result, neither PRPP would face adverse tax consequences, have obligations to make inquiries, nor have other compliance requirements as a result of holding shares or bonds of Pubco.

Example Two – Ordinary Course Investing by PRPP

Ed from Example One is an employee of Pubco – he is its chief executive officer. Pubco begins participating in a PRPP for its 5,000 employees. Pubco makes no special arrangements to exclude employees who are insiders or shareholders of Pubco and they contribute to the PRPP on the same basis as other employees. Pubco's PRPP is administered by a financial institution and has 80 other participating employers. The PRPP administrator has put 5% of the PRPP's assets into a mutual fund-style investing arrangement. The investment managers for the arrangement have discretion to choose investments based on agreed-upon parameters, and they purchase shares of Pubco. The investment managers have no knowledge of the membership of any of the PRPPs that are invested in the arrangement. Neither the PRPP administrator nor the investment managers could be expected to know that a member of the PRPP has a significant interest in Pubco. The PRPP would therefore not face any adverse tax consequences, nor have obligations to make inquiries or other compliance requirements as a result of holding the indirect interest in Pubco.

Example Three – Tax-planned Arrangement

An individual approaches a PRPP administrator on behalf of a group of clients. The individual is promoting an investment strategy for PRPPs. He recommends that the PRPP acquire shares of classes F through Z of Acme Corporation. He indicates that if the PRPP acquires these shares: a) they will earn returns of 8-15% annually, depending on the class; and b) he will bring the administrator a new group of PRPP clients. An administrator of a PRPP is expected to recognize that unusual promotions of this nature may involve restricted investments. An administrator who acquired, on behalf of a PRPP, shares of classes F through Z of Acme Corporation, which in fact turned out to be restricted investments for the PRPP, without further inquiry into the financing and ownership of Acme Corporation, "ought to have known" that these investments were restricted investments for the PRPP.

Example Four – Tax-planned Arrangement

A nationwide association that represents the interests of employees and self-employed individuals who work in a particular industry (for example, providing professional services) approaches a PRPP administrator about the possibility of establishing a PRPP for members of the association. The association indicates that it is interested in a PRPP that focuses on investing in the particular industry. Under these circumstances, it appears that many potential investments would be "restricted investments". Therefore, a failure by the administrator to make inquiries regarding whether any particular investment is restricted together with the acquisition of a restricted investment would be inconsistent with the administrator's obligations under subparagraph 147.5(3)(e)(i).

For further information, please see the commentary on the definition "restricted investment" and on new subsection 147.5(30).

New subparagraph 147.5(3)(*e*)(ii) applies only to "designated pooled pension plans" as defined in subsection 147.5(1). If a plan is a designated pooled pension plan, it will not be allowed to hold any investment in a participating employer or in a person or partnership that does not deal at arm's length with a participating employer. This rule is intended to prevent self-dealing arrangements such as the deduction by an employer of PRPP contributions, the value of which is returned to it in the form of an investment in the employer or a person or partnership that does not deal at arm's length with the employer. It is expected that PRPPs will generally have a large number of arm's length participants and that few PRPPs will be designated pooled pension plans. As a result, it is anticipated that this rule will rarely apply.

Under new subparagraph 147.5(3)(*f*), a PRPP becomes a revocable plan if the value of a member's rights under the plan depends on the value of (or income from or gains on) property that would be described in paragraph 147.5(3)(*e*) if the property were held in connection with the plan. This rule is intended to prevent the avoidance of the restrictions in paragraph 147.5(3)(*e*) through the use of investment or insurance products which track or derive their value from other investments. Under new subparagraph 147.5(3)(*g*), a PRPP becomes a revocable plan if it borrows money or other property for the purposes of the plan. This requirement is intended to prevent a PRPP from borrowing (for example, from the administrator or a person related to a plan member) in order to increase the total assets under management for the benefit of plan members. Such an arrangement could be used as part of an arrangement to effectively circumvent PRPP contribution limits by earning investment returns on behalf of PRPP members on money borrowed at favourable interest rates.

Under new paragraph 147.5(3)(*h*), a PRPP becomes a revocable plan if the plan or the plan administrator does not comply with a condition prescribed under the *Income Tax Regulations*. No additional conditions are being prescribed at this time.

ITA
147.5(4)

New subsection 147.5(4) sets out an additional circumstance where the registered status of a pooled registered pension plan becomes revocable by the Minister of National Revenue.

Under new subsection 147.5(4), a PRPP becomes a revocable plan if it fails to pay out the required minimum amount from a member's account for the year, determined as if the member's account were an account under a money purchase provision of a registered pension plan (RPP). That is, a PRPP that provides "variable benefits" is effectively required to pay out the same minimum amount to plan members who have attained 71 years of age as it would be if it were a defined contribution RPP that provided variable benefits.

ITA
147.5(5)

New subsection 147.5(5) of the Act specifies the types of benefits that may be provided by a PRPP. In general terms, the only types of benefits that can be provided directly through a PRPP are "variable benefits" (as described in paragraph 8506(1)(*e.1*) of the Regulations, as if the benefits were being provided under the money purchase provision of an RPP) or the payment of a single amount (as defined in new subsection 147.5(1)).

ITA
147.5(6)

New subsection 147.5(6) of the Act allows the Minister of National Revenue to impose additional conditions on PRPPs in general, a class of PRPPs (for example, designated pooled pension plans) or a particular PRPP. This provision is equivalent to subsection 147.1(5), which provides the Minister with essentially the same power in relation to RPPs.

ITA
147.5(7)

New subsection 147.5(7) of the Act provides that in order for an amendment to a PRPP to be accepted by the Minister of National Revenue, an application must be made in prescribed manner by the administrator and both the amendment and the PRPP as amended must comply with the registration conditions in subsection 147.5(2).

ITA
147.5(8)

New subsection 147.5(8) of the Act creates a tax exemption for income earned by a PRPP. This exemption is subject to an exception in relation to businesses carried on by a PRPP. A PRPP that carries on a business is subject to tax on its income from that business and, for this purpose, paragraphs (*a*) and (*b*) provide special rules for calculating that income. In particular, paragraph (*a*) requires that gains and losses from the disposition of property held in the business be reported on income account, and paragraph (*b*) prevents the PRPP from using trust rules to allocate amounts to plan members.

ITA
147.5(9)

New subsection 147.5(9) of the Act requires that the administrator of a PRPP exercise the care, diligence and skill of a reasonably prudent person to minimize the possibility that the registration of the plan maybe be revoked by the Minister of National Revenue. If the administrator fails to comply with this obligation, the administrator will be subject to a penalty under subsection 162(7) of $25 for each day that the failure continues (subject to a $100 minimum and a $2,500 maximum).

ITA
147.5(10)

New subsection 147.5(10) of the Act provides a deduction to an employer for its contributions to a PRPP in respect of its employees (or former employees). An employer contribution to a PRPP is deductible in computing the employer's income for a taxation year if the contribution is made in the year or within 120 days after the end of the year in respect of periods before the end of the year, is made in accordance with PRPP as registered, and was not deducted by the employer in computing its income for a previous year.

For further information, please see the related commentary on new paragraph 147.5(3)(*c*), which limits an employer's annual contribution in respect of each plan member to the RRSP dollar limit for the year (as defined in subsection 146(1)), except as otherwise directed by a member.

ITA
147.5(11)

New subsection 147.5(11) of the Act deems an individual's contributions to the individual's account under a PRPP to be a premium paid to an RRSP of the individual for various purposes of the Act. Specifically, as a result of this new deeming provision:

- Paragraph 60(*j*) will permit an individual to claim a deduction for amounts transferred to an account of the individual under a PRPP, where the amount is a lump sum payment out of an unregistered pension plan (attributable to services rendered by the individual or individual's spouse while a non-resident) and the amount was included in the individual's income under subparagraph 56(1)(*a*)(i).
- Paragraph 60(*j.1*) will provide a deduction, up to the limit specified under that paragraph, for the portion of a retiring allowance received by an individual that is contributed to a PRPP.
- Paragraph 60(*l*) will permit a qualified individual to claim a deduction for a specified portion of income received from retirement savings vehicles that are contributed to the individual's PRPP account. Note, however, that new subsections 147.5(21) and (22) allow a tax-deferred rollover for "qualifying survivors" without recourse to paragraph 60(*l*) deductions.
- References in section 146 to "premiums paid" are deemed to include contributions made to a PRPP. For example, subsections 146(5) and (5.1) will permit an individual to claim a deduction for contributions made to the individual's PRPP account.
- Pursuant to paragraphs 146.01(3)(*a*) and 146.02(3)(*a*), it will be possible to designate payments to a PRPP as repayments of amounts withdrawn under the Home Buyers' Plan or the Lifelong Learning Plan, subject to the conditions specified in those paragraphs, and if the PRPP permits such payments.
- For the purposes of applying the Part X.1 tax on non-deductible contributions to RRSPs, a PRPP member's contributions to his or her account are deemed to be contributions made to an RRSP. For further information, see the related commentary on section 204.02, which describes the application of Part X.1 to employer contributions made to PRPPs. For further information on the rules applicable to employer contributions to a PRPP member's account, please also see the commentary on paragraphs 6(1)(*a*), 20(1)(*q*), and 147.5(2)(*g*) and (3)(*c*).
- It will be possible for the Part X.5 tax on "accumulated income payments" from registered education savings plans to be reduced to the extent that the recipient of such a payment makes a deductible contribution to a PRPP for the year in which the payment is received.

ITA
147.5(12)

New subsection 147.5(12) of the Act deems an individual's account under a PRPP to be an RRSP under which the individual is the annuitant for various purposes of the Act and the *Income Tax Regulations*. As a result of this new deeming provision:

- Paragraph 18(1)(*u*) will prohibit an individual from claiming deductions for expenses related to services (e.g., administration services) provided in relation to the individual's account under a PRPP.
- An individual's benefit entitlement under a PRPP will be an "excluded right or interest" as defined in subsection 128.1(10) and therefore will be exempted from the deemed disposition rules that otherwise apply under section 128.1 when an individual immigrates to or emigrates from Canada.
- An amount transferred from a PRPP to an RRSP will be an "excluded premium" under subsections 146.01(1) and 146.02(1) that does not qualify as a repayment under the Home Buyers' Plan rules or Lifelong Learning Plan rules.

- Paragraph 146(8.2)(*b*) will provide an offsetting deduction where an individual withdraws a taxable amount from a PRPP that relates to the individual's non-deductible over-contributions to the individual's PRPP account.
- If over-contributions to a PRPP are subsequently withdrawn and deducted under subsection 146(8.2), those contributions, as a consequence of subsection 146(8.21), will be subsequently disregarded for the purposes of the attribution rules in subsections 146(8.3) and 146.3(5.1).
- Paragraphs 146(16)(*a*) and (*b*), subsections 146.3(14) and 147(19) and section 147.3 will permit direct transfers of amounts to a PRPP from any of an RRSP, a RRIF, a deferred profit sharing plan or an RPP.
- Subsection 146(21) will permit direct transfers of lump sum amounts from a specified pension plan (e.g., the Saskatchewan Pension Plan) to a RPPP.
- A retiring allowance paid to a non-resident and transferred to a PRPP will be subject to withholding tax under paragraph 212(1)(*j.1*) to the extent that a transfer to an RRSP would be subject to withholding tax.
- A payment to a non-resident from a deferred profit sharing plan and transferred to a PRPP will be subject to withholding tax under paragraph 212(1)(*m*) to the extent that a transfer to an RRSP would be subject to withholding tax.
- Under Parts LXXXIII and LXXXV of the *Income Tax Regulations*, transfers to and from an RRSP will be deemed to include transfers to and from a PRPP. For example, for purposes of past service pension adjustment regulations:
    - a transfer to a PRPP will be taken into account in determining an "excess money purchase transfer" under subsection 8303(7.1) of the *Income Tax Regulations* or a "money purchase transfer" under paragraph 8304(5.1)(*g*) of the *Income Tax Regulations;*
    - a transfer from a PRPP account will be taken into account in determining a qualifying transfer (under subsection 8303(6) of the Income Tax Regulations) to a defined benefit RPP; and
    - an individual pension plan member's balances in PRPP accounts will be included in the member's "designated savings arrangements" (as defined in subsection 8300(1) of the Income Tax Regulations) for purposes of subsection 8304(10) of the Income Tax Regulations.

ITA
147.5(13)

New subsection 147.5(13) of the Act is the general rule that requires amounts distributed out of a member's account under a PRPP to be included in computing the member's income for the year of the distribution. Subsection 147.5(13) does not apply in respect of amounts distributed after the death of a member or amounts described in subsection 147.5(22), the rule that specifies the tax consequences of transfers described in subsection 147.5(21).

In cases where new subsection 147.5(15) applies, the surviving spouse or common-law partner (i.e., the successor member) effectively becomes the new member and takes over the deceased member's rights in relation to the PRPP account. Amounts received by the successor member after the death of the original member are included in the successor member's income under subsection 147.5(13). For further information regarding subsection 147.5(15), please see the commentary on new subsections 147.5(14) to (19).

Subsection 147.5(14) applies in cases where there is no successor member and, subject to new subsection 147.5(16), deems a distribution to have occurred from the PRPP account immediately before the member's death. In other words, even though subsection 147.5(13) only applies to amounts distributed before death, this deeming rule can cause an amount to be included in the deceased member's income. The result of the interaction of these rules in the context of the death of a PRPP member is that an income inclusion for the terminal year of a PRPP member will only occur to the extent that there is neither a successor member nor a transfer of PRPP property to a “qualifying survivor” under subsection 147.5(16) and in respect of amounts up to the fair market value of the PRPP account on death.

For further information, please see the commentary on those provisions below.

ITA
147.5(14) to (20)

New subsections 147.5(14) to (20) of the Act provide rules that will apply on the death of a PRPP member. New subsections 147.5(21) to (23), which govern PRPP transfers, are also relevant in some situations involving the death of a PRPP member. In general terms, the tax results contemplated under the proposed rules are similar to those that apply under the existing RRSP/RRIF rules.

Death without a successor member

ITA
147.5(14)

When a member of a PRPP dies, new subsection 147.5(14) of the Act provides that all the property held in the member’s account is deemed to have been distributed immediately before the death. Since distributions from a member’s account are included in the member’s income under subsection 147.5(13), the effect of this rule is to include the value of the deceased member’s account in income for his or her last taxation year (unless the exception in subsection 147.5(16) with respect to a “qualifying survivor” applies). For further information, please see the commentary on the definition “qualifying survivor” in subsection 147.5(1) and on subsections 147.5(15) to (20).

PRPP account succession of property rules

ITA
147.5(15) and (16)

In order to provide flexibility without creating unintended tax outcomes, a number of rules are included that apply on the death of a PRPP member. One of the basic objectives is to have relatively simple rules applicable to a large number of common situations. For example, two methods are provided for leaving PRPP assets to a surviving spouse on the death of a PRPP member.

Surviving spouse or common-law partner

If a surviving spouse or common-law partner acquires all of the deceased member’s rights under the PRPP as “successor member”, new subsection 147.5(15) of the Act will apply and none of the other succession rules are applicable. If, instead, a surviving spouse or common-law partner is not a successor member, new subsection 147.5(16) applies. Under subsection 147.5(16), a PRPP distribution to a “qualifying survivor” (which includes a spouse or common-law partner) is included in the qualifying survivor’s income, except to the extent that the distribution is transferred in accordance with new subsections 147.5(21) and (22). These provisions provide a number of options for surviving spouses and common-law partners, including transferring the distribution to another PRPP account or to an RRSP. For more information regarding tax-deferred transfers, please see the commentary on subsections 147.5 (21) to (23).

Other “qualifying survivor” – financially-dependent child or grandchild

In addition to surviving spouses or common-law partners, the other category of “qualifying survivor” is a financially-dependent child or grandchild. A distribution from a deceased’s member’s PRPP to a financially-dependent child or grandchild is generally included in the child or grandchild’s income under new subsection 147.5(16).

Amendments to paragraph 60(*l*) and to subsection 60.02(1) permit deductions in computing income in relation to transfers in certain circumstances. For further information, please see the commentary on those amended provisions.

Deemed distribution to qualifying survivor

ITA
147.5(17)

New subsection 147.5(17) of the Act permits the legal representative of a deceased PRPP member's estate and a qualifying survivor to make an election in respect of PRPP death benefits that have been paid to the estate. If this election is made, the PRPP death benefits will be treated as a having been paid directly to the qualifying survivor from the PRPP. This means that the PRPP death benefits will be included in the survivor's income under subsection 147.5(16) and not in the income of the deceased PRPP member under subsection 147.5(14). If a corresponding amount is used to acquire a qualifying annuity or is paid into a PRPP, RRSP or RRIF under which the qualifying survivor is a member or an annuitant and certain other conditions are satisfied, the qualifying survivor will be entitled to an offsetting deduction under paragraph 60(*l*).

For further information, please see the commentary on the definition "qualifying survivor" in subsection 147.5(1).

Post-death increase or decrease in value

ITA
147.5(18) to (20)

As a consequence of the rules described above, most amounts distributed from the account of a deceased PRPP member will either be included in the income of the deceased member or a qualifying survivor, or will benefit from a tax-deferred transfer. New subsection 147.5(18) of the Act creates an income inclusion in the hands of the recipient of a distribution for amounts that have not been included in the income of any taxpayer under another rule and that have not been transferred in accordance with new subsections 147.5(21) to (23).

The amount of the income inclusion is determined by the formula A – B. Variable A is the amount being distributed from the account under the PRPP to the taxpayer. Variable B, which will in many cases reduce the income inclusion to nil, is the amount designated by the administrator in relation to the distribution. The amount designated by the administrator cannot exceed the lesser of two amounts. The first amount is the amount being distributed. The second amount is the amount by which the fair market value of all property held in the account immediately before death exceeds the total amounts designated for variable B in relation to all other distributions.

For example, assume that a PRPP member, Dave, directs by will that the first $100,000 of his PRPP account should be transferred to his wife, Emily, on his death. The remainder is left to his sister, Joanne. When Dave dies, his PRPP account has a fair market value of $150,000. As described above, $100,000 will be included in Emily's income under subsection 147.5(16), except to the extent that she transfers it in accordance with subsections 147.5(21) to (23). The remaining $50,000 will be included in Dave's income for his last taxation year. However, there are some delays in relation to the estate administration and by the time Dave's executor is ready to direct a distribution of the remainder of the account to Joanne, the remaining assets in the account are worth $62,000. The administrator applies the formula in subsection 147.5(18) as follows:

- On the first distribution (i.e., the distribution to Emily), variable A is $100,000 – the amount distributed. Variable B is also $100,000, because the amount distributed was less than the fair market value of the plan at Dave's death, and there are no other distributions to account for under paragraph (*b*) of variable B.
- On the second distribution (i.e., the distribution to Joanne), variable A is $62,000 – the amount distributed. Variable B is $150,000 minus the total of all amounts included in variable B in relation to

all other distributions. Therefore, variable B is $150,000 minus $100,000 (the amount of variable B in relation to the distribution to Emily) or $50,000.

- In respect of the distribution to Joanne, the administrator designates $50,000 as the "tax-free" (i.e., previously recognized) portion of the distribution and Joanne includes $12,000 in her income for the year in which she receives the distribution, which represents the increase in value of the PRPP account after Dave's death.

Subsection 147.5(18) is worded in this way in order to ensure that it operates appropriately, even in situations of multiple distributions and fluctuating asset values. In the context of multiple distributions, the administrator of the PRPP is left with some flexibility to allocate tax consequences among beneficiaries of the estate. It is assumed that administrators will do so reasonably and in proportion to the various beneficiaries' interests in the estate.

A similar rule in new subsection 147.5(19) creates a deduction, available in computing the income of the deceased member, to the extent that the total amount distributed from the PRPP account, once the account is wound up, is less than the total amounts included in income or transferred under the other rules. New subsection 147.5(20) limits the availability of this deduction in circumstances where the last distribution occurs after the end of the year following the year in which the member dies. In those circumstances, the deduction is available only if it is approved by the Minister of National Revenue. These rules are very similar to existing subsections 146(8.92) and (8.93), which apply in respect of post-death RRSP losses.

ITA
147.5(21)

New subsection 147.5(21) of the Act provides conditions relating to the transfer of an amount from a PRPP member's account to certain other registered vehicles or for the purchase of a qualifying annuity. If those conditions are satisfied, subsection 147.5(21) allows the transfer to be made on a tax-deferred basis.

New paragraph 147.5(21)(*a*) requires that the amount be transferred in a "single amount", which is defined in subsection 147.5(1) as an amount that is not part of a series of periodic payments.

New paragraph 147.5(21)(*b*) sets out the individuals on whose behalf an amount from a member's account may be transferred:

- the member;
- a spouse or common-law partner or former spouse or common-law partner who is entitled to the amount as a result of a division of property after the breakdown of the marriage or common-law partnership; or
- the spouse or common-law partner at the date of the member's death.

New paragraph 147.5(21)(*c*) requires that the single amount from the PRPP account be transferred to the individual's account under a PRPP or RPP, to an RRSP or RRIF of the individual, or to a licensed annuities provider to acquire a "qualifying annuity" for the individual. For further information, please see the commentary on the definition "qualifying annuity" in subsection 147.5(1).

For information about rollovers on behalf of a minor or infirm child who was financially dependent on a deceased PRPP member, please see the commentary on paragraph 60(*l*).

ITA
147.5(22)

New subsection 147.5(22) of the Act provides for a tax-deferred transfer of an amount out of a PRPP if the transfer satisfies the conditions in subsection 147.5(21). Specifically, subsection 147.5(22) provides that such an amount transferred on behalf of an individual shall not be included in computing the individual's income and that no taxpayer may claim a deduction in respect of the amount.

ITA
147.5(23)

New subsection 147.5(23) of the Act governs the taxation of payments from a qualifying annuity acquired with funds transferred from a member's account under a PRPP in accordance with subsection 147.5(21). Any payments under the annuity contract are included in the recipient's income for the year in which they are received (there are no immediate tax consequences on the acquisition of the qualifying annuity). If the individual disposes of (e.g., commutes) the annuity, the proceeds from that disposition of the annuity are included in the individual's income for the year of disposition.

For further information, please see the commentary on subsection 147.5(21) and on the definition "qualifying annuity" in subsection 147.5(1).

ITA
147.5(24)

New subsection 147.5(234 of the Act provides that, as a first step in revoking the registration of a PRPP, the Minister of National Revenue must notify the administrator of the PRRP in writing of the Minister's intent to revoke the plan's registration as of a specified date. A notice of intent may be given if the Minister has determined that:

- the plan does not comply with registration conditions specified in new subsection 147.5(2);
- the plan is not administered in accordance with the terms of the plan as registered by the Minister;
- the plan is a revocable plan, as determined by any of the conditions specified in new subsections 147.5(3) or (4);
- a condition that has been imposed on the plan by the Minister (see new subsection (147.5(6)) is not complied with; or
- registration of the plan under the *Pooled Registered Pension Plans Act* or a similar law of a province (that requires registration under that law) has been refused or revoked.

ITA
147.5(25)

New subsection 147.5(25) of the Act requires that a notice of intent to revoke the registration of a PRPP must specify the date on which the proposed revocation will be effective. That date cannot be earlier than the earliest date on which a condition described in any of paragraphs 147.5(24)(*a*) to (*e*) applies to the PRPP. Upon receipt of a notice of intent, the plan administrator or a participating employer may, under amended subsection 172(3), appeal to the Federal Court of Appeal. For further information, see the commentary on subsection 172(3).

ITA
147.5(26)

New subsection 147.5(26) of the Act provides that, after the Minister of National Revenue has given a notice of intent to revoke the registration of a PRPP (under subsections 147.5(24) and (25)), the Minister may give a notice that the registration of the PRPP is revoked as of a specified date. That date cannot be earlier than the date stated in the notice of intent. As well, a notice of revocation cannot be given until after 30 days after the notice of intent was given.

ITA
147.5(27)

Under new subsection 147.5(27) of the Act, the registration of a PRPP is revoked as of the date specified in the Minister of National Revenue's notice of revocation given under subsection 147.5(25) unless, upon an application made before the determination of an appeal, the Federal Court of Appeal or a judge of that Court orders otherwise.

ITA
147.5(28)

If a plan administrator applies for the revocation of the registration of a PRPP, new subsection 147.5(28) of the Act allows the Minister of National Revenue to revoke the registration of the PRPP. Where the application of this subsection is the reason for the revocation of the registration of a PRPP, the effective date of the revocation will not be earlier than the date specified in the administrator's request.

However, an administrator's voluntary request for revocation of registration does not prevent the Minister from giving a notice of intent to revoke the registration as of a date earlier than the date requested by the administrator if any of the conditions listed in subsection 147.5(24) are applicable at that earlier date. For further information, please see the commentary on subsections 147.5(24) to (27).

ITA
147.5(29)

New subsection 147.5(29) of the Act provides a rule, similar to existing rules that apply in the registered pension plan context (see, for example, subsection 8514(2.1) of the *Income Tax Regulations*), that specify that all related employers – as well as various structural units of a trade union – are deemed to be a single employer for the purposes of the definition "designated pooled pension plan" in subsection 147.5(1).

ITA
147.5(30)

New subsection 147.5(30) of the Act provides the meaning of "significant interest", which is relevant in determining whether an investment is a restricted investment for a pooled pension plan. A member has a significant interest in a corporation if the member is a "specified shareholder" (within the meaning assigned by subsection 248(1)). A member has a significant interest in a partnership or trust if the member is a "specified unitholder" (within the meaning assigned to that term in the new definition added to subsection 248(1)) or if the member's interest in the partnership or trust is worth more than 10% of the total fair market value of all the interests in the partnership or trust.

ITA
147.5(31)

New subsection 147.5(31) of the Act will generally enable Indians (as defined in the *Indian Act*) and their employers to contribute to PRPPs out of or from tax-exempt employment income. Specifically, it includes a PRPP member's exempt earned income (as defined in subsection 147.5(1) in the member's earned income under subsection 146(1) for PRPP contribution purposes (but not for RRSP contribution purposes).

For more information, see the related commentary on the definitions "exempt earned income" and "exempt-income contribution amount" under subsection 147.5(1).

ITA
147.5(32)

New subsection 147.5(32) of the Act provides that member contributions to a PRPP out of or from exempt earned income (i.e., income that would be earned income but for the non-inclusion in income under paragraph 81(1)(*a*) of the Act as it applies with respect to the *Indian Act*) may not be deducted in computing the member's taxable income for any taxation year.

Because of the tax exemption provided under section 87 of the *Indian Act* and the connecting factors test derived from the Supreme Court of Canada decision *Williams v. The Queen* (92 D.T.C. 6320), where participation in a PRPP by an Indian (as defined under the *Indian Act*) is an employer-related benefit under an employment contract and contributions that are not deductible under new subsection 147.5(32) are made from tax-exempt earned income, it is expected that the Minister of National Revenue will generally treat the benefit payments in respect of these non-deductible contributions as being exempt from tax. This treatment will parallel the existing treatment that applies to payments from registered pension plans in respect of contributions made from an Indian's tax-exempt employment income.

For example, Anne is an Indian (as defined in the *Indian Act*) who earns $40,000 of exempt earned income and $20,000 of taxable earned income in 2015 from the same employer. Under the terms of her employment contract, Anne and her employer each contribute 5% of her income to a PRPP under which the employer participates. With respect to Anne’s $3,000 contribution to the PRPP in 2015, $2,000 of that contribution may not be deducted against her current or future taxable income. The $2,000 contribution from exempt earned income, and any earnings on that $2,000, will be exempt from tax when paid to Anne out of the PRPP.

For further information, please see the related commentary on “exempt earned income” and “exempt-income contribution amount” under subsection 147.5(1) and the commentary on subsection 146(5) which is concurrently amended to prohibit “exempt-income contribution amounts” from being deducted against taxable sources of earned income.

ITA
147.5(33)

New subsection 147.5(33) of the Act modifies Part X.1 of the Act (taxes in respect of overcontributions to RRSPs and PRPPs) as it applies to any contribution made to a PRPP by an Indian (as defined in the *Indian Act*) that is an exempt-income contribution amount (as defined in subsection 147.5(1)). New subsection 147.5(11) deems PRPP contributions to be premiums paid to an RRSP for several purposes of the Act, including for purposes of Part X.1. Subsection 147.5(33) will effectively facilitate the determination of “unused non-deductible PRPP room” for a PRPP member who is an Indian with “exempt earned income” (as those terms are defined in subsection 147.5(1)) and will generally ensure that exempt-income contribution amounts do not attract taxes under Part X.1 to the extent that they do not exceed unused room (i.e., the sum of unused RRSP deduction room and unused non-deductible PRPP room). Specifically, new paragraph 147.5(33)(*a*) applies the Part X.1 rules to an Indian PRPP member as if that member’s earned income for a year included the member’s exempt earned income for the year. New paragraph 147.5(33)(*b*) deems the PRPP member’s exempt-income contribution amount for the year to have been deducted under subsection 146(5) in computing the member’s income for the year.

Example

In his first 2 years of employment (2015 and 2016), Andrew, an Indian, earns $30,000 per year of exempt earned income from Employer A and $6,000 per year of other earned income from Employer B. In 2016, Employer A becomes a participating employer under a PRPP and contributes $2,000 to Andrew’s account. Andrew contributes an additional $1,000 (an exempt-income contribution amount) via payroll deductions.

At the end of 2015, Andrew’s unused RRSP contribution room (as defined in subsection 146(1)), for purposes of deductible contributions to RRSPs or PRRPs in 2016 or later years, is $1,080 (18% x $6,000). In order to determine his unused non-deductible PRPP room, paragraph 147.5(33)(a) includes his $30,000 exempt earned income in the determination of earned income under subsection 146(1), and paragraph 147.5(33)(b) deems his exempt-income contribution amount (i.e., $1,000 in 2016) to have been deducted against his income for the year of the contribution.

Accordingly, Andrew’s unused non-deductible PRPP room at the end of year 2015 and at the end of year 2016 are determined as follows.

End of year 2015:

A = 18% x ($30,000 + $6,000) = $6,480

B = $1,080 unused RRSP deduction room

Unused non-deductible PRPP room = A – B = $6,480 - $1,080 = $5,400

End of year 2016:

A = $6,480 + $6,480 (2016) - $2,000 (employer) - $1,000 (member) = $9,960

B = $1,080 (2015) + $1,080 (18% of 2016 earnings) = $2,160 unused RRSP deduction room

Unused non-deductible PRPP contribution room = A – B = $9,960 - $2,160 = $7,800

Paragraph 147.5(33)(*c*) applies where a PRPP member has contributed an exempt-income contribution amount in a taxation year that exceeds the member's unused non-deductible PRPP room for the taxation year. A concurrent amendment to subsection 146(1) adds a new subparagraph (*b*)(iv) of the description D in the definition "unused RRSP contribution room" and reduces the taxpayer's unused RRSP deduction room by the amount of the excess contribution. Paragraph 147.5(33)(*c*) ensures that those excess contributions are not double-counted under subparagraphs (*b*)(i) and (*b*)(iv) of the description D of the definition "unused RRSP deduction room" when paragraph 147.5(33)(*b*) deems the full amount of a taxpayer's exempt-income contribution to have reduced the taxpayer's unused RRSP deduction room.

ITA
147.5(34)

New subsection 147.5(34) of the Act allows a PRPP member to designate an amount of contribution by the member to a PRPP in a taxation year as being exempt-income contribution amount for a taxation year. The amount designated may not exceed the lesser of the member's contributions to a PRPP in the taxation year (other than subsection (32) amounts) and the member's unused non-deductible PRPP room at the end of the preceding taxation year. The effect of such a designation by a taxpayer who is an Indian (as defined in the *Indian Act*) is to reduce the taxpayer's unused non-deductible PRPP room by an amount of contributions that would otherwise have qualified for a deduction in computing income. Because of the concurrent amendment to subsection 146(5), a PRPP member may not deduct an exempt-income contribution amount (made in any taxation year) is computing income.

ITA
147.5(35)

New subsection 147.5(35) of the Act provides a regulation-making power to the Governor in Council. In particular, it authorizes regulations:

- prescribing conditions applicable to plan administrators;
- requiring information returns;
- allowing the Minister to require any person to provide information for the purpose of administering the provisions relating to PRPPs; and
- generally to carry out the purposes and provisions of the Act relating to PRPPs and the determination and reporting of specified amounts.

Clause 37

Life insurance policies - definitions

ITA
148(1)

Subsection 148(1) of the Act requires the inclusion in income of certain amounts from the disposition of a life insurance policy. These rules do not apply to certain types of life insurance policies, including a policy that is, or is issued pursuant to, an RRSP or a RRIF.

Subsection 148(1) is amended, consequential on the introduction of new section 147.5 pertaining to pooled registered pension plans (PRPPs), to add a new paragraph 148(1)(*b.3*) to provide an exception for a life insurance policy that is, or is issued pursuant to, a PRPP.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 38

Exemption for PRPP trust

ITA
149(1)

Section 149 of the Act provides that no tax is payable under Part I on the taxable income of certain persons for the period in a taxation year during which the person is a person listed in that section.

New paragraph 149(1)(*u.3*) is added to provide such an exemption for a trust governed by a pooled registered pension plan (PRPP), to the extent provided under new section 147.5 (i.e., the rules applicable to PRPPs). For further information, please see the commentary on new subsection 147.5(8). That subsection sets out the conditions under which no tax is payable by a trust governed by a PRPP.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 39

Reassessment where certain deductions claimed

ITA
152(6)(*f.3*)

In general terms, subsection 152(6) of the Act provides for the reassessment of tax payable for a taxation year if a deduction or credit is being claimed as the result of a carry back from a later taxation year. Paragraph 152(6)(*f.3*) provides for the reassessment of taxpayer returns where deductions are claimed under subsections 146(8.92) or 146.3(6.3) in respect of post-death registered retirement savings plan (RRSP) and registered retirement income fund (RRIF) losses. Paragraph 152(6)(*f.3*) also provides for reassessments in circumstances where subsections 146(8.9) or 146.3(6.2) apply to reduce the income otherwise deemed to be included in the income of a deceased RRSP or RRIF annuitant.

Paragraph 152(6)(*f.3*) is amended to provide for the reassessment of taxpayer returns if an amount claimed under new subsections 147.5(14) or 147.5(19) reduces an income inclusion in respect of a deceased member of a pooled registered pension plan (PRPP). For example, the amount required to be included in income as a result of a deemed distribution under subsection 147.5(14) may be reduced by a subsequent transfer to a qualifying survivor to which new subsection 147.5(16) applies. Depending on the circumstances, it may be necessary to rely on paragraph 152(6)(*f.3*) to reduce or eliminate the income inclusion on the deceased member’s return to reflect the payment to a qualifying survivor.

For further information regarding PRPPs, please see the commentary on new section 147.5.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 40

Definitions – "net tax owing"

ITA
156.1(1)

Subsection 156.1(1) of the Act sets out definitions that are relevant in determining whether an individual is required to make tax instalment payments. The description of A in the definition "net tax owing" is amended consequential on the introduction of new Part XI.4, under which a special tax is imposed on excessive allocations to specified employees (as defined in subsection 248(1)) under employees profit sharing plans (EPSPs). Specifically, the amendment ensures that taxes payable under Part XI.4 in respect of excess EPSP amounts (as defined in new subsection 207.8(1)) are included in the calculation of an individual's instalment base for a year. For further information, see the commentary on section 207.8.

This amendment applies to the 2012 and subsequent taxation years.

Clause 41

Appeal from refusal to register

ITA
172(3)

Subsection 172(3) of the Act provides for appeals to the Federal Court of Appeal where there are disputes regarding the status of certain organizations or plans.

New paragraphs 172(3)(*h*) and (*i*) are added to permit appeals where the Minister of National Revenue refuses to register a pooled pension plan, gives a notice of intent to revoke the registration of a pooled registered pension plan (PRPP) or refuses to accept an amendment to a PRPP.

The closing words of subsection 172(3) are amended to provide that an appeal under paragraph 172(3)(*h*) or (*i*) may be made by the administrator of the pooled pension plan or PRPP.

ITA
172(5)

Subsection 172(5) of the Act provides that where an application is made for the registration of a pension plan, or for the acceptance of an amendment to a registered pension plan, the Minister of National Revenue will be considered to have refused the application if the applicant has not been notified of the Minister's decision within one year of the application. This rule enables the applicant to institute an appeal to the Federal Court of Appeal under subsection 172(3) where the Minister does not make a decision with respect to an application within one year.

Paragraph 172(5)(*a*) is amended to add a reference to pooled pension plans and paragraph (*b*) is amended to add a reference to PRPPs. As a result, if the Minister has not made a decision with respect to an application for registration of a pooled pension or an application for an amendment to a PRPP within one year of the application, the administrator of the pooled pension plan or PRPP will have the right to appeal to the Federal Court of Appeal.

For further information regarding PRPPs, please see the commentary on new section 147.5.

These amendments will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 42

Appeal to Federal Court of Appeal

ITA
180(1)

Subsection 180(1) of the Act provides that an appeal to the Federal Court of Appeal under subsection 172(3) may not be filed after 30 days from the time that notice of the Minister of National Revenue's decision was mailed, unless this time limit is extended by the Court.

Subsection 180(1) is amended consequential on the amendments to subsection 172(3) pertaining to pooled registered pension plans (PRPPs). New paragraph 180(1)(*c.2*) is added to provide that an appeal of the revocation of registration of a PRPP may not be made after 30 days from the date on which the Minister mailed the notice of intent to revoke the registration. As well, paragraph 180(1)(*d*) is amended to add a reference to PRPPs. As a result, an appeal of the Minister's decision to refuse an amendment to a PRPP may not be made after 30 days from the date on which the Minister communicated the decision.

For further information, please see the commentary on new section 147.5 and on the amendments to subsection 172(3).

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 43

Over-contributions to RRSP or PRPP

ITA
204.2

Part X.1 of the Act imposes a penalty tax in respect of excess contributions made to registered retirement savings plans (RRSPs). The amount of tax payable in respect of any month is 1% of an individual's cumulative excess amount at the end of that month.

As a consequence of the introduction of pooled registered pension plans (PRPPs), an individual's unused RRSP deduction room (see subsection 146(1)) and deductible RRSP premiums (see subsection 146(5)) will be reduced each year by contributions to a PRPP made by the individual or by the individual's employer to an account of the individual under a PRPP. Accordingly, consequential amendments are being made to section 204.2 to ensure that non-discretionary contributions to a PRPP in respect of an individual will not be included in the individual's cumulative excess amount and will not be subject to the monthly 1% tax under subsection 204.1(2.1).

The amendments to section 204.2 do not expressly add references to the contributions that an individual member makes to a PRPP. However, for the purposes of various sections of the Act including section 146 (RRSPs) and Part X.1, new subsection 147.5(11) deems an individual's contributions to his or her account under a PRPP to be premiums paid to an RRSP of the individual.

For further information, please see the commentary on new section 147.5 (including new rules in subsections 147.5(31) to (34) pertaining to exempt-income contribution amounts), and on the amendments to the definition "unused RRSP deduction room" in subsection 146(1) and to subsection 146(5).

These amendments will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

ITA
204.2(1.1)

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 includes the amount of RRSP deduction room available to the individual for the year plus a margin of $2,000 plus a "group RRSP amount" (variable D) in respect of the individual.

Subsection 204.2(1.1) is amended to replace the term "group RRSP amount" in variable D with the term "group plan amount", consequential on related amendments to section 204.2 that ensure non-discretionary contributions to a PRPP in respect of an individual will not be included in the individual's "cumulative excess amount" and will not be subject to Part X.1 tax.

ITA
204.2(1.2)

Subsection 204.2(1.2) of the Act provides rules for determining the amount of an individual's undeducted RRSP premiums at any time. This amount is used in computing the individual's cumulative excess amount in respect of RRSPs under subsection 204.2(1.1). As a consequence of new PRPP rules in section 147.5 and related amendments to section 146 (RRSP rules), variables I and J in the formula H + I – J in subsection 204.2(1.2) are amended to take into account contributions made by an individual's employer to the individual's PRPP account and withdrawals from the PRPP account, in the year and before the time of the determination.

Subparagraph (*a*)(iii) of variable I in subsection 204.2(1.2) is amended to add transfers from a PRPP to an RRSP to the list of transfers that are not considered for purposes of the Part X.1 tax to be premiums paid to an RRSP. Variable I is also amended to add a new paragraph (*c*) to include in an individual's undeducted RRSP premiums any amounts contributed in the year and before the time of the determination to the individual's PRPP account by an employer or former employer. However, as a result of the amendments to subsection 204.2(1.1) and 204.2(1.3), non-discretionary contributions to a PRPP in respect of an individual will not be included in the individual's cumulative excess amount and will not be subject to Part X.1 tax.

Paragraph (*a*) of variable J in subsection 204.2(1.2) is amended to subtract from undeducted RRSP premiums any amounts that are withdrawn from the individual's PRRP account in the year and before the time of the determination and that are included in computing the individual's income for the year.

Although subsection 204.2(1.2) will not expressly refer to an individual's contributions to a PRPP, new subsection 147.5(11) deems an individual's contributions to his or her PRPP account to be premiums paid to an RRSP of the individual. As a result, an individual's PRPP contributions in a year are included in computing the individual's undeducted RRSP premiums under subsection 204.2(1.2).

ITA
204.2(1.3)

Subsection 204.2(1.3) of the Act provides rules for determining the "group RRSP amount" of an individual for the purposes of paragraph 204.2(1.1)(*b*). An individual's group RRSP amount for a year is the amount that is needed to ensure that Part X.1 tax does not apply in that year to certain non-discretionary group RRSP contributions made in the year.

Subsection 204.2(1.3) is amended to replace the term "group RRSP amount" (in the preamble and in variable K) with "group plan amount" and to replace the term "qualifying group RRSP premium paid by an individual" in variable F with "qualifying group plan amount in respect of an individual". This amendment is consequential to related amendments to section 204.2 that ensure non-discretionary contributions to a PRPP in respect of an individual will not be included in the individual's cumulative excess amount and will not be subject to Part X.1 tax.

ITA
204.2(1.31)

Subsection 204.2(1.31) of the Act defines “qualifying group RRSP premium”, which is relevant in determining an individual’s group RRSP amount under amended subsection 204.2(1.3). A qualifying group RRSP premium of an individual is the non-elective portion of an RRSP contribution made to an RRSP that is part of a “qualifying arrangement” (as defined in subsection 204.2(1.32)) and that was remitted to the RRSP on behalf of the individual by a person who is required to remunerate the individual for services rendered. It does not include the discretionary portion of an individual’s RRSP contribution, that is, the portion the individual could have prevented from being paid to the RRSP, by making an election or exercising any other right under the arrangement (or by failing to do one of these things) after starting to participate in the arrangement and within 12 months preceding the payment. However, the elective portion does not include any amount that, had it not been paid to the RRSP, would have been required to be remitted on behalf of the individual to another RRSP or to a money purchase provision of a registered pension plan.

Subsection 204.2(1.31) is amended to replace the term “qualifying group RRSP premium paid by an individual” with “qualifying group plan amount in respect of an individual” (consequential on a similar amendment to subsection 204.2(1.3)) and to include in that amount, in addition to premiums paid to the an RRSP of the individual, amounts contributed by the individual’s employer or former employer to the individual’s PRPP account. New subsection 147.5(11) deems an individual’s contributions to the individual’s account under a PRPP to be a premiums paid to an RRSP of the individual.

Subsection 204.2(1.31) is further amended so that (in addition to discretionary RRSP contributions) discretionary employer contributions to an individual’s PRPP account are not included in the definition of “qualifying group plan amount”.

For further information, please see the commentary on new subsection 147.5(11) and on amendments to the definition “unused RRSP deduction room” in subsection 146(1) and to subsection 146(5).

ITA
204.2(5)

New subsection 204.2(5) of the Act provides an express right for a member of a PRPP to withdraw an amount (e.g., an overcontribution) from his or her PRPP account, notwithstanding any locking-in provisions contained in pension standards legislation applicable to PRPPs, if the withdrawal is made to reduce the tax that would otherwise be payable under Part X.1. This right is provided only to the extent the member cannot otherwise withdraw funds from plans other than PRPPs (e.g., from non-locked-in RRSPs) to achieve the reduction in tax.

Clause 44

Retirement compensation arrangements

ITA
207.5

In general terms, retirement compensation arrangements (RCAs) are funded, employer-sponsored pension or other retirement savings arrangements that are not registered pension plans or registered retirement savings plans. They are subject to special tax rules. “Retirement compensation arrangement” is defined in subsection 248(1) of the Act. Budget 2012 announced new rules to address tax planning arrangements that had developed using RCAs. The new rules generally extend the “prohibited investment” and “advantage” concepts from Part XI.01 of the Act – which currently apply to registered retirement savings plans, registered retirement income funds and tax-free savings accounts – to RCAs. The definitions “prohibited investment” and “advantage”, along with a number of supporting definitions and rules, and taxes that apply in relation to prohibited investments and advantages, are introduced in Part XI.3 (the part of the Act that deals with RCAs). Budget 2012 also announced a measure to restrict the ability of an RCA to obtain a refund of RCA refundable tax in circumstances where the property of the RCA has declined in value; this restriction is also introduced as an amendment to Part XI.3.

Definitions

ITA
207.5(1)

Subsection 207.5(1) of the Act provides definitions that are relevant for the purposes of Part XI.3. Several definitions are being amended or introduced to implement the Budget 2012 measures.

"advantage"

The new definition "advantage" in subsection 207.5(1) describes amounts derived from several types of transactions or events in respect of which unintended tax benefits could be obtained. The amount of an advantage is subject a tax equal to its fair market value under new section 207.62. Under new section 207.64, the Minister of National Revenue may waive all or a portion of the tax in appropriate circumstances. For more information, please see the commentary on those provisions.

In order to maintain consistency with the definition "advantage" in subsection 207.01(1), paragraphs (*a*) to (*e*) of the definition "advantage" in subsection 207.5(1) closely follow paragraphs (*a*) to (*e*) of the definition "advantage" in subsection 207.01(1), with modifications that reflect the specific attributes of RCAs. For example, no exception for payments into an RCA by its "issuer or carrier" is included in paragraph (*a*) because RCAs do not have issuers or carriers.

In the RCA context, the key aspects of the definition "advantage" are the inclusion of income and gains on prohibited investments held in connection with an RCA, and the inclusion of the amount of any RCA strip. "Prohibited investment" and "RCA strip" are new defined terms in subsection 207.5(1). For more information, please see the commentary on those definitions.

The definition "advantage" applies after March 28, 2012, except that it does not apply in relation to transactions or events involving property acquired before March 29, 2012 if either of two conditions is met. First, the amount of what would otherwise be an advantage involving subject property of an RCA held before March 29, 2012 will not be treated as an "advantage" or subject to the advantage tax under new section 207.62 to the extent that the amount is included in the income of a beneficiary of the RCA, or an employer in respect of the RCA, for the taxation year in which the amount arose or the following year.

Second, where the property that would or could otherwise give rise to an advantage is a promissory note or similar debt obligation, its retention by an RCA will not cause the advantage rules to apply if commercially reasonable payments of principal and interest are made at least annually after 2012 in respect of the note or obligation and no RCA strip occurs in relation to the RCA. An amendment to the terms of a note or obligation to provide for such payments is deemed not to be a disposition or acquisition of the note or obligation for the purposes of applying this transitional rule.

"prohibited investment"

The new definition "prohibited investment" in subsection 207.5(1) is essentially the same as the definition of that term in subsection 207.01(1) in Part XI.01. However, instead of referring to a "controlling individual" (the term used in subsection 207.01(1)), the new definition refers to a "specified beneficiary" of an RCA. An RCA can have more than one specified beneficiary. For more information, please see the commentary on the new definition "specified beneficiary".

This amendment applies after March 28, 2012. For more information regarding the coming into force of the prohibited investment and advantage rules in respect of RCAs, please see the commentary on the new definition "advantage" and the taxes imposed under new sections 207.61 and 207.62.

"RCA strip"

The new definition "RCA strip", which is very similar in concept to the existing definition "RRSP strip" in subsection 207.01(1), generally describes amounts extracted from an RCA without being included in income under Part I. The new definition "RCA strip" includes a purpose test and applies where there has been a reduction in value of the subject property of the RCA as part of a transaction or event (or a series of transactions or events) one of the main purposes of which was to enable a specified beneficiary (or a person who does not deal at arm's length with the beneficiary) to use or obtain a benefit as a result of that reduction and there has been no related income inclusion. The definition will apply, for example, in circumstances where an RCA has directly or indirectly made a loan to, or acquired a debt of, a specified beneficiary or a person who does not deal at arm's length with the beneficiary, and steps are undertaken to ensure that the loan cannot be repaid. The definition is not limited to loan-back transactions, however, and could apply in other circumstances (such as dilution of share value) where the basic operation of the RCA regime would otherwise be circumvented.

An RCA strip is included in the definition "advantage" under subsection 207.5(1). As a consequence, an RCA strip will be subject to tax under new section 207.62 and the amount of the tax will equal the amount of the RCA strip. This tax may be waived or cancelled under new section 207.64.

The definition "RCA strip" applies after March 28, 2012. For example, it could apply in relation to a debt acquired by an RCA before March 29, 2012 if the value of the debt is impaired after March 28, 2012 as part of a series of transactions that meets the test set out in the definition.

"significant interest"

The new definition "significant interest" in subsection 207.5(1) adopts the meaning provided by subsection 207.01(4) for the same term.

This amendment applies after March 28, 2012.

"specified beneficiary"

The new definition "specified beneficiary" in subsection 207.5(1) refers to an individual who has an interest or right in relation to an RCA and who has, or had, a significant interest in an employer in respect of the RCA.

This amendment applies after March 28, 2012.

Refund

ITA
207.5(3)

Under the RCA rules in Part XI.3 of the Act, the concept "refundable tax" for an RCA in essence operates as a pool that maintains a running balance of 50% of the amount by which contributions to the RCA plus income and capital gains (net of losses and capital losses) of the RCA exceeds distributions from the RCA. At the end of each taxation year of an RCA trust, the refundable tax of the RCA for the current year is compared with its refundable tax at the end of the preceding year. If the RCA's refundable tax for the year exceeds its refundable tax for the preceding year, that excess is payable as a tax under subsection 207.7(1). Alternatively, if the RCA's refundable tax for the preceding year exceeds its refundable tax for the current year, subsection 207.7(2) provides that the excess is refundable to the RCA by the Minister of National Revenue.

Consequently, it is advantageous for RCAs to have a low "refundable tax" balance at the end of the current year. Normally the refundable tax balance of an RCA can be reduced, and tax refunds triggered, by making distributions to the beneficiaries of the RCA. However, in situations where the property held by an RCA has declined in value, there might not be enough property in the RCA to support the distributions necessary to trigger a refund of tax under subsection 207.7(2). To address such situations, subsection 207.5(2) allows an RCA in certain circumstances to make an election to set its refundable tax at the end of the current year to be an amount lower than the amount that would otherwise be determined.

In addition to the introduction of "prohibited investment" and "advantage" rules for RCAs, Budget 2012 announced a measure to restrict the availability of the election in subsection 207.5(2). New subsection 207.5(3) implements this restriction. It generally provides that the election under subsection 207.5(2) will not be available if any part of a decline in value of the property of the RCA is reasonably attributable to a prohibited investment or to an advantage in respect of the RCA. This restriction will not apply if the Minister of National

Revenue is satisfied that it is just and equitable to allow the subsection 207.5(2) election to be made, having regard to all the circumstances. Where the Minister is satisfied that the subsection 207.5(2) election should be permitted, the Minister may adjust the amount deemed by subsection 207.5(2) to be the refundable tax of the arrangement to take into account all or part of the decline in value of the subject property.

This amendment applies in relation to tax paid on RCA contributions made after March 28, 2012 and on income earned, capital gains realized and losses incurred, in respect of such contributions.

Clause 45

Tax on prohibited investments

ITA
207.61(1) to (4)

New section 207.61 of the Act introduces a tax in respect of prohibited investments for RCAs. New section 207.61 is similar to section 207.04, except that it applies only in relation to prohibited investments – the non-qualified investment rules do not apply to RCAs.

New subsection 207.61(1) provides that the custodian of an RCA trust is liable to pay the prohibited investment tax if the RCA acquires a prohibited investment or if an existing investment becomes a prohibited investment after March 29, 2012. An investment would become a prohibited investment, for example, in circumstances where an RCA holds debt of a corporation, a specified beneficiary of the RCA holds 800 out of 10,000 outstanding Class A shares, and, after March 29, 2012, a 25% shareholder in the same class of shares in the corporation redeems their 2,500 shares, turning what had been an 8% interest in the corporation held by the specified beneficiary into a 10.67% interest. In contrast, a significant interest in a corporation, such as a debt of a corporation controlled by a specified beneficiary of an RCA, already held by the RCA before March 29, 2012 is not subject to this tax.

New subsection 207.61(2) provides that the amount of tax payable in section 207.61 is 50% of the fair market value of the prohibited investment at the time it was acquired or became a prohibited investment. New subsection 207.61(3) generally provides for a refund of the prohibited investment tax on the disposition of the prohibited investment, unless new paragraph 207.61(3)(*b*) applies. Paragraph 207.61(3)(*b*) applies to deny a refund if

- the custodian knew, or ought to have known, at the time the investment was acquired, that the investment was (or would become) a prohibited investment, or
- the property is not disposed of by the RCA before the end of the year after the year in which the tax arose (or such later date that the Minister of National Revenue considers reasonable).

In other words, a refund is generally available in relation to the prohibited investment tax if the property was acquired by mistake and disposed of promptly.

New subsection 207.61(4) provides a deemed-disposition-and-reacquisition rule for property that becomes, or ceases to be, a prohibited investment for an RCA. This rule assists in the calculation of advantage tax (under subsection 207.62(1)) in relation to income and capital gains on prohibited investments.

These amendments apply after March 28, 2012. In this regard, a rule ensures that amendments to the terms of a promissory note or a similar debt obligation that is subject property of an RCA acquired before March 29, 2012 will not be considered to result in a disposition or acquisition of the note or obligation. Without this rule, amendments to a note or obligation made for the purpose of establishing commercially reasonable payments of principal and interest in order to avoid the application of the definition “advantage” might be considered to constitute an acquisition of a prohibited investment.

Tax in respect of advantages

ITA
207.62(1) and (2)

New section 207.62 of the Act imposes a tax on advantages in respect of an RCA. It is based closely on section 207.05 in Part XI.01 of the Act. New subsection 207.62(1) establishes that the custodian of an RCA trust has primary liability for the advantage tax. New subsection 207.62(2) provides that the tax is equal to the amount of the advantage.

This amendment applies after March 28, 2012.

Joint liability

ITA
207.63

New section 207.63 of the Act creates joint, several and (for civil law purposes) solidary liability for a specified beneficiary of an RCA in respect of the taxes imposed under sections 207.61 or 207.62, to the extent that the beneficiary participated in, assented to, or acquiesced in the transaction or event or series of transactions or events that resulted in the liability. This means that a specified beneficiary, such as, for example, an adult child of an owner-manager who was employed part-time in the parent's business, who had no knowledge at all of the tax planning that gave rise to the section 207.61 or 207.62 tax would not normally have any joint, several or solidary liability for the taxes. However, a specified beneficiary who has knowledge of the basic intent, or expected result, of a particular plan or arrangement may have acquiesced in the transaction or event or series of transactions or events.

This amendment applies after March 28, 2012.

Waiver of tax payable

ITA
207.64

New section 207.64 of the Act authorizes the Minister of National Revenue to waive or cancel a tax (or a portion of a tax) payable because of any of sections 207.61 to 207.63 if the Minister considers it just and equitable to do so having regard to all the circumstances. New paragraphs 207.64(*a*) and (*b*) in effect provide examples of circumstances where it may be just and equitable to waive or cancel these taxes.

This amendment applies after March 28, 2012.

Deemed distribution

ITA
207.65

New section 207.65 of the Act provides a rule for the calculation of "refundable tax" of an RCA in circumstances where the custodian of an RCA has a liability to pay a tax under section 207.61 or 207.62. The payment of these taxes out of property of the RCA is deemed to be a distribution from the RCA. This ensures that the 50% refundable tax payable under subsection 207.7(1) is not also payable on amounts paid as tax under section 207.61 or 207.62 (to the extent that the taxes under those sections are not waived, cancelled or refunded).

This amendment applies after March 28, 2012.

Clause 46

Tax on excess EPSP amounts

ITA
207.8

To ensure that employees profit sharing plans (EPSPs) are used for their intended purposes, Budget 2012 proposed a targeted measure to discourage excessive employer contributions. This measure is in the form of a special tax payable by a specified employee (as defined in subsection 248(1) of the Act) on an "excess EPSP amount".

New subsection 207.8(1) defines "excess EPSP amount" for the purposes of new Part XI.4 of the Act. Under new subsection 207.8(1), a specified employee's excess EPSP amount for a taxation year in respect of an employer is the amount determined by the formula

$$(A - 20\% \times B)$$

where A is, in general terms, the portion of employer EPSP contributions that is allocated to the specified employee for the year and B is, in general terms, the specified employee's total income for the year from employment with the employer (determined without reference to paragraph 6(1)(*d*) and sections 7 and 8). In other words, EPSP allocations to a specified employee that exceed 20% of the specified employee's regular salary will generally be considered excess EPSP amounts.

New subsection 207.8(2) imposes a special tax on a specified employee who has an excess EPSP amount for a taxation year. The tax payable on the excess EPSP amount is 29% plus one of three rates set out in the description of variable B:

- If the specified employee is resident in the Province of Quebec at the end of the taxation year, B is 0%.
- If the specified employee is resident in a province other than the Province of Quebec at the end of the taxation year, B is the highest percentage rate of tax, including surtaxes but not taxes that are capped at a maximum amount, imposed by the province for the year on the income of an individual who is a resident of the province.
- In any other case, B is 14%. For example, this rate would apply in the case of non-resident specified employees.

New subsection 207.8(3) allows the Minister of National Revenue to waive or cancel all or part of a tax imposed under subsection 207.8(2) if it is just and equitable to do so. This provision is also relevant for the purposes of new paragraph 8(1)(*o.2*) as the deduction under that paragraph is not available in respect of any portion of the specified employee's excess EPSP amount for which the specified employee's tax for the year is waived or cancelled under this provision.

New subsection 207.8(4) sets out the tax return filing and payment of tax obligations in respect of taxes payable under Part XI.4. Specifically, it provides that a person liable for Part XI.4 tax for a taxation year must file a return on or before the person's tax return filing-due date for the year and on or before the person's balance-due day for the year, pay to the Receiver General the amount of tax payable under this Part by the person for the year.

New subsection 207.8(5) provides that Part XI.4 is subject to certain general rules relating to assessments and administration under the Act.

Section 207.8 applies to the 2012 and subsequent taxation years. However, it does not apply in respect of payments made by an employer to an EPSP before March 29, 2012, or before 2013 pursuant to an obligation arising under a written agreement or arrangement entered into before March 29, 2012.

Clause 47

Definitions

ITA
211(1)

“registered life insurance policy”

Subsection 211(1) of the Act defines a number of terms for the purposes of Part XII.3 of the Act, which imposes a special tax on the taxable Canadian life investment income of a life insurer. Registered life insurance policies, which include any life insurance policy that is issued as a registered retirement savings plan, are specifically excluded from the scope of this tax.

The definition “registered life insurance policy” is amended, consequential on the introduction of new section 147.5 pertaining to pooled registered pension plans (PRPPs), to include a life insurance policy that is issued as or under a PRPP.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 48

Tax on Canadian income of non-resident

ITA
212(1)(*h*)

Section 212 of the Act imposes a tax, commonly referred to as a “non-resident withholding tax”, on certain payments made by residents of Canada to non-residents. Paragraph 212(1)(*h*) includes superannuation or pension benefits paid to non-residents as payments subject to the withholding tax. An amendment to the definition “superannuation or pension benefit” in subsection 248(1) will clarify that benefits paid from pooled registered pension plans (PRPPs) are generally superannuation or pension benefits for the purposes of the Act. Paragraph 212(1)(*h*) also lists in subparagraphs (iii) to (iv.1) a number of exclusions from the application of the withholding tax. Paragraph 212(1)(*h*) is amended in two respects as a consequence of the introduction of PRPPs.

Subparagraph 212(1)(*h*)(ii) is added to exclude from withholding tax the portion of a PRPP payment to a non-resident person that has been designated by the PRPP administrator in accordance with new subsection 147.5(17). In effect, this allows PRPP payments that have already been included in the income of a taxpayer under the PRPP succession rules to be paid free of withholding tax.

Existing subparagraph 212(1)(*h*)(iii.1) exempts from withholding tax a payment that is transferred directly to a registered pension plan, registered retirement savings plan or registered retirement income fund for the benefit of the non-resident person if the transfer is made pursuant to an authorization in prescribed form. Subparagraph 212(1)(*h*)(iii.1) is amended to provide that a non-resident will be entitled to similarly transfer pension benefits (including PRPP benefits) to a PRPP free of withholding tax where the transferred amount would not be included in computing the individual’s income for the taxation year by virtue of new subsection 147.5(21) if the individual were resident in Canada throughout the year.

For further information regarding PRPPs, please see the commentary on new section 147.5.

These amendments will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 49

Foreign affiliate dumping

ITA
212.3

Overview

Included in this package are various amendments to the Act to address so-called “foreign affiliate dumping”. The main provision in this regard is new section 212.3. Supporting amendments are also made to existing provisions of the Act in order to address variations of the main types of foreign affiliate dumping transactions.

In general terms, these new rules result in deemed dividends subject to non-resident withholding tax or reductions of paid-up capital. Subject to certain exceptions, these rules are designed to deter Canadian subsidiaries of foreign-based multinational groups from making investments in non-resident corporations that are, or become as a result of the investment or a series of transactions that includes the investment, foreign affiliates of the Canadian subsidiary in situations where these investments can result in the inappropriate erosion of the Canadian tax base. The erosion can arise because of the exempt treatment of most dividends from these foreign affiliates in combination with the interest deductions on debt incurred to make such investments (Part I tax base) or the ability to extract corporate surplus from Canada free of dividend withholding tax (affecting directly the Part XIII tax base and, indirectly through the diminution of income-earning capacity in Canada, the Part I tax base). In the case of Canadian subsidiaries of foreign-based multinational groups, the result of planning that exploits Canada’s system of foreign affiliate taxation is inappropriate, particularly when undertaken without providing any significant economic benefits to Canada.

Targeted investments include purchases of, and subscriptions for, shares of a foreign affiliate, capital contributions and loans to a foreign affiliate and acquisitions of shares of a Canadian company the assets of which are substantially foreign affiliate shares. Supporting rules are provided in the context of certain corporate migrations as well as capital contributions to the Canadian subsidiary by its foreign parent.

There are certain exceptions to these new foreign affiliate dumping rules, which can be grouped into three categories: pertinent loans or indebtedness, corporate reorganizations and strategic business expansions.

- The pertinent loans or indebtedness exception allows loans to a foreign affiliate to be excluded from the foreign affiliate dumping rules on an elective basis. Such an election then subjects these loans to an interest imputation regime vis-à-vis the Canadian subsidiary (in new subsection 17.1(1)). Although not directly related to the foreign affiliate dumping measure, a similar election is being provided in the context of loans made directly by a Canadian subsidiary to its foreign parent and certain other related non-residents (for further information, see the commentary on subsection 15(2) and related provisions).
- The corporate reorganization exceptions are generally aimed at excluding certain direct and indirect acquisitions of foreign affiliate shares, in the context of a corporate reorganization, from the application of the rules where they do not represent a new investment in the foreign affiliate.
- The exception for strategic business expansions allows Canadian subsidiaries to invest in foreign affiliates in certain circumstances where the Canadian subsidiary is making a strategic acquisition of (or an investment in) a business that is more closely connected to its business than to those of certain non-resident members of the multinational group and officers of the Canadian subsidiary, with the required Canadian nexus, are the predominant decision makers in a commercial and economic sense.

Other rules ensure that certain foreign-controlled Canadian subsidiaries that structure their foreign affiliate investments in a manner that does not allow them to obtain Canadian tax benefits are able to avoid the consequences of the foreign affiliate dumping rules – through the deemed dividend set-off rule in subsection 212.3(7) and the paid-up capital reinstatement rule in subsection 212.3(9), as discussed below.

These rules apply prospectively – that is, they generally apply to transactions and events that occur after March 28, 2012. However, the Government believes that existing anti-avoidance rules in the Act, including the general anti-avoidance rule in section 245, would apply to certain past cases of foreign affiliate dumping. As is the case with respect to all other provisions of the Act, it is intended that such existing anti-avoidance rules apply to any new foreign affiliate dumping transactions that might not technically come within the ambit of this new legislation but that – on a full appreciation of the circumstances of the transactions – seek to frustrate the purpose of these foreign affiliate dumping rules, as described in this commentary and other Government documents.

Foreign affiliate dumping — conditions for application

ITA
212.3(1)

New subsection 212.3(1) of the Act provides the conditions for the application of subsection 212.3(2), the main operative rule for the foreign affiliate dumping rules in new section 212.3. By virtue of subsection 212.3(1), subsection 212.3(2) will apply to an "investment" (as defined in subsection 212.3(10)) in a non-resident corporation (referred to in section 212.3 and in this commentary as the "subject corporation") by a corporation resident in Canada (referred to in section 212.3 and this commentary as the "CRIC") where three conditions are met.

The first condition, in paragraph 212.3(1)(*a*), is that the subject corporation must be a foreign affiliate of the CRIC immediately after the investment is made (or must become a foreign affiliate of the CRIC as part of a series of transactions or events that includes the making of the investment). By virtue of the "series of transactions" reference, subsection 212.3(2) can also apply where a portfolio (non-foreign affiliate) interest in a non-resident corporation is acquired by a CRIC in contemplation of a future event as a result of which the non-resident becomes a foreign affiliate of the CRIC.

The second condition, in paragraph 212.3(1)(*b*), is that the CRIC must be controlled by a non-resident corporation (referred to in section 212.3 and in this commentary as the "parent") at the time the investment is made (or become so controlled as part of a series of transactions or events that includes the making of the investment). This condition generally distinguishes between Canadian-based multinationals, to which the rules do not apply, and foreign-based multinationals with Canadian subsidiaries, to which the rules are intended to apply.

The third condition, in paragraph 212.3(1)(*c*), is that neither subsection 212.3(16) nor 212.3(18) applies in respect of the investment. In general terms, subsection 212.3(16) provides an exception from the application of subsection 212.3(2) in circumstances where the investment is made by the CRIC in the context of a strategic business expansion. Subsection 212.3(18) provides exceptions from the application of subsection 212.3(2) where the CRIC's investment in the subject corporation is made in the context of certain reorganization transactions that do not involve a new investment by the CRIC in the subject corporation. For further details, see the commentary on those subsections, below.

Foreign affiliate dumping — consequences

ITA
212.3(2)

New subsection 212.3(2) of the Act is the main operative rule in section 212.3 and it applies when the three conditions in subsection 212.3(1) are satisfied.

Subsection 212.3(2) can apply to deem dividends to be paid to the parent by the CRIC or can cause the paid-up capital (PUC) of the shares of the CRIC to be reduced. Although not contained in section 212.3, the application of subsection 212.3(2) can also cause certain contributed surplus to be ignored in the application of the thin capitalization rules in subsection 18(4) or in the determination of deemed dividends under subsection 84(1). For further information on the inter-relationship between section 212.3 and those two subsections, see the commentary on those subsections.

Paragraph 212.3(2)(*a*) deems a dividend to be paid by the CRIC to the parent in an amount equal to the fair market value of any properties transferred, obligations assumed or incurred, or benefits otherwise conferred, by the CRIC, or property transferred to the CRIC in repayment of an amount owing to the CRIC, that can reasonably be considered to relate to the investment in the subject corporation. The result of a deemed dividend under paragraph 212.3(2)(*a*) is that the parent is subject to Part XIII dividend withholding tax under subsection 212(2).

The reference in paragraph 212.3(2)(*a*) to "benefit otherwise conferred" is intended to capture any other means by which the CRIC transfers value to the subject corporation (for example, a forgiveness of debt) and is meant to be interpreted and applied in a fashion similar to that of the shareholder benefit conferral rule in subsection 15(1). (The contribution of capital rule in paragraph 212.3(10)(*b*) has corresponding language.) However, under the new "secondary adjustment" rules in section 247 of the Act, subsection 212.3(2) will not apply to a benefit conferral to the extent that new subsection 247(12) applies in respect of the benefit conferral, as provided under new subsection 247(15).

Paragraph 212.3(2)(*b*) causes the PUC of the CRIC to be reduced where the creation of the PUC is related to an investment in a subject corporation. Thus, where a subject corporation is transferred by the parent to the CRIC in exchange for shares of the CRIC, any PUC increase resulting from that transfer would be negated.

Where, for example, a parent first contributes cash to the CRIC in exchange for shares of the CRIC with PUC equal to the amount of the cash and the CRIC subsequently uses that cash to make an investment in a subject corporation, it is intended that only the deemed dividend rule apply – the PUC creation would not be considered to relate to the investment, as it is one step removed. It is similarly intended that only the deemed dividend rule would apply where a contribution of capital is made (rather than a contribution in exchange for shares), and that none of paragraphs 84(1)(*c.1*) to (*c.3*) would apply to prevent such contributed surplus from subsequently being converted into PUC. Similar reasoning applies in situations where a CRIC borrows money and uses the proceeds to purchase shares or debt of a foreign affiliate – the incurring of the debt itself is not intended to give rise to a deemed dividend: only the cash payment is intended to give rise to a deemed dividend.

An election is available under subsection 212.3(3) to have the dividend deemed to have been paid by certain other corporations resident in Canada rather than the CRIC and, in certain circumstances, to have a non-resident corporation other than the parent be deemed to be the recipient of the dividend. It is also possible, in many cases, for a deemed dividend to be reduced by certain amounts of PUC, as discussed below under subsections 212.3(6) and (7).

The "reasonably considered to relate" language in subsection 212.3(2) is mainly intended to deal with situations in which the "indirect acquisition" rule in paragraph 212.3(10)(*f*) is applicable, i.e., where the CRIC acquires foreign affiliate shares indirectly by acquiring shares of a Canadian corporation, in certain circumstances. In these situations, it would often be the case that the acquired Canadian corporation would also own assets other than foreign affiliate shares and thus, it is necessary to reasonably allocate the consideration paid by the CRIC to the foreign affiliate assets. In the absence of specific factors that indicate otherwise, it would be expected that the most reasonable way to allocate the consideration would be on a pro-rata basis based on the fair market value of the underlying assets acquired.

Dividend substitution election

ITA
212.3(3)

New subsection 212.3(3) of the Act provides an elective rule that allows for all or a portion of a dividend that would otherwise be deemed, under paragraph 212.3(2)(*a*), to be paid by the CRIC to the parent to instead be deemed to be paid by certain other Canadian-resident corporations in the corporate group, to either the parent or another non-resident corporation in the group. Under the election, only Canadian-resident corporations that are “qualifying substitute corporations”, as defined in new subsection 212.3(4), can be substituted for the CRIC as payers of the deemed dividend.

In order to be valid, an election under subsection 212.3(3) must allocate the full amount of the deemed dividend otherwise arising under paragraph 212.3(2)(*a*) between shares of some or all of the qualifying substitute corporations and the CRIC, on a class-by-class basis. The ability to have another non-resident corporation (in these notes referred to as a “substitute non-resident”) take the place of the parent as the dividend recipient is effected by having the substitute non-resident be a party to the election.

The election under subsection 212.3(3) must be filed jointly by the CRIC, all qualifying substitute corporations in respect of the CRIC (including qualifying substitute corporations to which no portion of the deemed dividend amount is allocated in the election) and the parent, or the parent and the substitute non-resident, if applicable, by the earliest of the filing-due dates of the CRIC and the qualifying substitute corporations for their taxation years that include the time the investment is made.

The result of the election is that, under subparagraph 212.3(3)(*a*)(i), the amount of the deemed dividend otherwise arising under paragraph 212.3(2)(*a*) is reduced by the total of all the deemed dividend amounts allocated in the election to classes of shares of qualifying substitute corporations. The remaining portion of the deemed dividend is then deemed, under subparagraph 212.3(3)(*a*)(ii), to be paid to the parent, or the substitute non-resident, as the case may be, as either a single dividend in respect of a single class of shares of the CRIC, or as multiple dividends in respect of multiple classes of shares of the CRIC, depending on the allocation set out in the election. In addition, under paragraph 212.3(3)(*b*), each qualifying substitute corporation is deemed to pay to either the parent or the substitute non-resident a dividend in the amount, and in respect of the class of shares, specified in the election.

Where an election is made under subsection 212.3(3), subsections 212.3(6) and (7) provide a further rule that, in certain circumstances, allows for the dividends that are otherwise deemed to arise under subparagraph 212.3(3)(*a*)(ii) and paragraph 212.3(3)(*b*) to be offset against the PUC of the shares of the qualifying substitute corporations and the CRIC in respect of which those dividends are deemed to be paid. Such PUC can also be reinstated, in certain circumstances, under subsection 212.3(9). For further information, please see the commentary on those provisions.

Qualifying substitute corporation

ITA
212.3(4)

New subsection 212.3(4) of the Act defines a “qualifying substitute corporation”, in respect of a CRIC, for the purposes of section 212.3. A qualifying substitute corporation is defined as a Canadian-resident corporation that is controlled by the parent corporation of the CRIC and that has an equity percentage (as defined in subsection 95(4)) in the CRIC, where at least one share of the capital stock of the corporation is owned by the parent or a non-resident corporation with which the parent does not deal at arm’s length.

This definition is relevant for the purposes of the dividend substitution election in subsection 212.3(3) and the dividend/PUC set-off rules in subsections 212.3(6) and (7). Generally, the qualifying substitute corporation and dividend substitution concepts are meant to accommodate structures where one or more other Canadian-resident corporations are situated between the parent and the CRIC in a corporate chain.

Modification of terms – paragraph (10)(*e*)

ITA
212.3(5)

New subsection 212.3(5) of the Act specifies the amount deemed to be paid as a dividend under paragraph 212.3(2)(*a*) where an investment in a subject corporation is deemed under paragraph 212.3(10)(*e*) to be made by a CRIC by virtue of the extension of the maturity date of a debt obligation owing by the subject corporation to the CRIC or the extension of the redemption date of shares of the subject corporation owned by the CRIC.

Subsection 212.3(5) deems the CRIC to have transferred to the subject corporation property with a fair market value equal to the amount owing, in the case of a debt obligation, and equal to the fair market value of the share, in the case of redeemable shares. For further information, see the commentary below on paragraph 212.3(10)(*e*).

Reduction of deemed dividend

ITA
212.3(6) and (7)

New subsections 212.3(6) and (7) of the Act provide rules that allow for dividends that are otherwise deemed to arise under paragraph 212.3(2)(*a*), or under paragraph 212.3(3)(*b*), to be offset against the PUC of the shares of the CRIC, or qualifying substitute corporations in respect of the CRIC, in certain circumstances. These new rules recognize that, absent the creation of PUC, the tax benefits sought under the types of transactions that the foreign affiliate dumping rules are intended to curtail do not generally arise in cases where equity capital is raised by a CRIC and invested offshore through foreign affiliates. For example, if a CRIC is listed on a Canadian stock exchange and raises equity in order to finance mining activities offshore (carried on indirectly through foreign affiliates), these new rules provide a mechanism, subject to certain conditions, to avoid the tax consequences arising under the foreign affiliate dumping rules. However, these rules also allow existing amounts of cross-border PUC in a corporate group to reduce a deemed dividend, whether or not the PUC arises in the course of an investment that is subject to the foreign affiliate dumping rules.

Subsection 212.3(6) provides the conditions for subsection 212.3(7) (the operative rule) to apply. Paragraph 212.3(6)(*a*) deals with situations where an election is filed under subsection 212.3(3) in respect of an investment in a subject corporation, and requires that two conditions be met. The first condition, in subparagraph 212.3(6)(*a*)(i), is that either the parent, or another non-resident corporation that does not deal at arm's length with the parent, must own shares of every class of the CRIC, or a qualifying substitute corporation, to which a deemed dividend amount has been allocated in the election filed under subsection 212.3(3). This condition ensures that the PUC offset under subsection 212.3(7) will result in a reduction of "cross-border" PUC in respect of each class of shares to which it applies.

The second condition, in subparagraph 212.3(6)(*a*)(ii), is that the election under subsection 212.3(3) must result in the greatest possible total amount of hypothetical PUC reduction. In other words, in order to qualify for the PUC offset under subsection 212.3(7), deemed dividend amounts must be allocated, in the election under subsection 212.3(3), to classes of shares of the CRIC and of the qualifying substitute corporations in a manner that maximizes the aggregate reduction to cross-border PUC under subparagraph 212.3(7)(*b*)(i). In order to satisfy this condition, the election under subsection 212.3(3) would generally have to allocate the deemed dividend under paragraph 212.3(2)(*a*) first to the class of shares of the CRIC or qualifying substitute corporation of which the parent or non-arm's length non-resident owns the greatest proportionate share, then to the class of which the parent or non-arm's length non-resident owns the second greatest proportionate share, and so on.

Paragraph 212.3(6)(*b*), on the other hand, is non-elective and it provides that the PUC offset in subsection 212.3(7) will apply to automatically offset the PUC in respect of the CRIC's shares against the dividend otherwise deemed under paragraph 212.3(2)(*a*) to be paid by the CRIC to the parent where certain conditions are satisfied. The main conditions relate to the classes of shares of the CRIC and the manner in which those shares are held.

If the CRIC has only one class of shares and each share is owned by the parent, a non-resident corporation that does not deal at arm's length with the CRIC or a person that deals at arm's length with the CRIC, then any dividend otherwise deemed to arise under paragraph 212.3(2)(*a*) will be set off against the CRIC's PUC existing immediately before the time of the investment in the subject corporation. Where there are two or more classes of shares of the CRIC, there is an additional requirement to trace the creation of at least some of the

PUC in respect of the CRIC's shares to a transfer of property to the CRIC, which property is subsequently used by the CRIC to make an investment (including an indirect investment described in paragraph 212.3(10)(*f*)) that gives rise to a deemed dividend under paragraph 212.3(2)(*a*). To the extent that tracing requirement is met, the CRIC will be able to reduce its deemed dividend by the amount of PUC so traced.

Paid-up capital adjustment

ITA
212.3(8)

New subsection 212.3(8) of the Act ensures that the reductions to paid-up capital made by paragraphs 212.3(2)(*b*) and (7)(*b*) do not produce an inappropriate result where, because of a share redemption, acquisition, or cancellation or a reduction of paid-up capital, subsection 84(3), (4) or (4.1) subsequently treats the corporation as having paid a dividend on the shares to which the paid-up capital reduction relate. Similar rules exist in various other provisions of the Act that adjust paid-up capital – see for example paragraph 85(2.1)(*b*), subsection 212.1(2), and, as discussed above, subsection 128.1(3).

One difference with the rule in subsection 212.3(8) is that it also takes into account any increase in paid-up capital under the so-called "paid-up capital reinstatement" rule in subsection 212.3(9), which is discussed below.

Paid-up capital reinstatement

ITA
212.3(9)

New subsection 212.3(9) of the Act allows for a reinstatement of PUC in respect of a class of shares of a CRIC or a qualifying substitute corporation immediately before a distribution/reduction of capital in certain circumstances where the PUC was initially reduced by the operation of paragraph 212.3(2)(*b*) or (7)(*b*). A similar PUC reinstatement provision is available in the context of certain corporate emigrations, as provided for in new subsections 219.1(3) to (5), discussed below.

The amount of the PUC reinstatement is determined as the least of three amounts. The first is the amount of the distribution/reduction of paid-up capital. The second is the amount by which the PUC was reduced by the operation of paragraph 212.3(2)(*b*) or (7)(*b*), at the time of the original investment in the foreign affiliate, less the amount of any prior PUC reinstatements in respect of the relevant class of shares in respect of the investment.

The third amount is based on the extent to which the distribution is traceable to the original investment. Two situations are contemplated: either i) the original foreign affiliate shares, or substituted shares, are distributed, or ii) proceeds from a disposition of such shares or dividends or reductions of capital in respect of such shares are distributed. In the case of a distribution of shares, the amount is based on the fair market value of the shares. In the case of proceeds or dividends/reductions of capital, the amount is based on the amount of the proceeds or dividends/reductions of capital, but there is also a requirement to trace the distributions, directly or indirectly, to the proceeds or dividends/reductions of capital and to establish that the proceeds or dividends/reductions of capital arose within 180 days of the distribution. In respect of proceeds from a disposition of the subject shares, the proceeds cannot arise from a disposition in respect of which subsection 212.3(18) applies. If they do, the PUC reinstatement rule will not be available.

Investment in subject corporation

ITA
212.3(10)

New subsection 212.3(10) of the Act defines an "investment", in a subject corporation made by a CRIC, for the purposes of section 212.3. By virtue of paragraph 212.3(10)(*a*), an investment for these purposes includes an acquisition of shares of the subject corporation by the CRIC. This includes acquisitions by the CRIC of newly issued shares of the subject corporation. It also includes acquisitions by the CRIC of issued and outstanding shares of the subject corporation from the CRIC's non-resident parent corporation, another corporate group member or an arm's length person or partnership.

By virtue of paragraph 212.3(10)(*b*), an investment for purposes of section 212.3 includes a contribution of capital to the subject corporation by the CRIC. Thus, a transfer of property by the CRIC to the subject corporation is an investment for such purposes even if the CRIC does not take back any shares or debt of the subject corporation. In addition, for these purposes, paragraph 212.3(10)(*b*) deems a contribution of capital to include any transaction or event under which a benefit is conferred on the subject corporation by the CRIC. This benefit conferral rule is similar to the rule in subsection 15(1) that applies in the shareholder benefit context.

By virtue of paragraph 212.3(10)(*c*), an investment for purposes of section 212.3 includes a transaction as part of which an amount becomes owing by the subject corporation to the CRIC, unless the amount owing satisfies either of two exceptions. The first exception, in subparagraph 212.3(10)(*c*)(i), is for an amount owing that becomes owing to the CRIC in the ordinary course of the CRIC's business and is repaid, other than as part of a series of loans and repayments, within 180 days of the day it becomes owing. The "ordinary course of business" exception could apply, for example, where the CRIC supplies property to the subject corporation on credit in the ordinary course of the CRIC's business operations (and the resulting debt is repaid in the manner required by that exception). The second exception, in subparagraph 212.3(10)(*c*)(ii), is for an amount owing that the CRIC and the parent have jointly elected under paragraph 212.3(11)(*c*) to have treated as a "pertinent loan or indebtedness", as discussed below. Subject to the foregoing two exceptions, paragraph 212.3(10)(*c*) is generally intended to include, as investments for purposes of section 212.3: loans made by the CRIC to the subject corporation; transactions resulting in trade debts or other unpaid purchase price owing by the subject corporation to the CRIC; and any other transaction as part of which an amount becomes owing by the subject corporation to the CRIC.

By virtue of paragraph 212.3(10)(*d*), an investment for purposes of section 212.3 includes an acquisition of a debt obligation of the subject corporation by the CRIC from another person, subject to two exceptions. The first exception, in subparagraph 212.3(10)(*d*)(i), is for an acquisition made in the "ordinary course of the business" of the CRIC from a person with which the CRIC deals, at the time of the acquisition, at arm's length. The second exception, in subparagraph 212.3(10)(*d*)(ii), is for an amount owing that the CRIC and the parent have jointly elected under paragraph 212.3(11)(*c*) to have treated as a "pertinent loan or indebtedness", as discussed below. Paragraph 212.3(10)(*d*) is intended to include acquisitions of outstanding debts of a subject corporation from any person (or, by virtue of the look-through rules in subsection 212.3(25), any partnership), whether dealing at arm's length or non-arm's length with the CRIC.

Paragraph 212.3(10)(*e*) provides that an investment for purposes of section 212.3 includes an extension of either the maturity date of a debt obligation owing by the subject corporation to the CRIC (other than a debt obligation that is a pertinent loan or indebtedness, as defined in subsection (11), immediately after the extension) or the date on which shares of the subject corporation held by the CRIC are to be redeemed, acquired or cancelled by the subject corporation. For example, where the subject corporation issued a debt obligation or preferred shares to the CRIC before March 29, 2012 (i.e., the effective date of the foreign affiliate dumping rules) that would have been an investment under paragraph 212.3(10)(*c*) or 212.3(10)(*a*), respectively, had they instead been issued after March 28, 2012, an extension of the maturity date of the debt or the redemption date of the preferred shares would constitute an investment. Where, instead, the debt obligation or the shares are issued by the subject corporation to the CRIC after March 28, 2012, and subsection 212.3(2) applies to such investment, a subsequent extension of the maturity or redemption date, as the case may be, would result in a second investment to which subsection 212.3(2) would apply.

For the purposes of determining the quantum of a dividend the CRIC is deemed to pay to its non-resident parent under paragraph 212.3(2)(*a*) in respect of an investment described in paragraph 212.3(10)(*e*), subsection 212.3(5) deems the CRIC to have transferred property to the subject corporation (that relates to the investment) with a fair market value equal to the amount owing on the debt obligation, or the fair market value of the shares, immediately after the investment. These rules are intended to give results similar to those that would occur had the debt been repaid and re-loaned, or had the shares been redeemed and re-issued, as the case may be, instead of being extended.

Paragraph 212.3(10)(*f*) provides that an investment for the purposes of section 212.3 includes certain indirect acquisitions of foreign affiliate shares by a CRIC, through the direct acquisition of shares of another Canadian-resident "target" corporation. (For these purposes, it is important to take into account the partnership "look-through" rules in subsection 212.3(25).) Specifically, where a CRIC acquires directly shares of another Canadian-resident target corporation – which itself holds, directly or indirectly, shares of one or more foreign affiliates – the indirect acquisition of each such foreign affiliate by the CRIC will be considered a separate investment in a subject corporation if the total fair market value of all the foreign affiliate shares held, directly or indirectly, by the Canadian target corporation comprises more than 75% of the total fair market value of all the properties owned by the Canadian target.

The parenthetical language in paragraph 212.3(10)(*f*) requires that the computation of the total fair market value of all the properties owned by the Canadian target corporation be made without taking into account any debts of any Canadian corporation in which the Canadian target has a direct or indirect interest. As a result, where the Canadian target owns shares of another Canadian corporation, the fair market value of those shares is to be determined for these purposes without taking into account any debts of that other corporation. The debts of the Canadian target are also not taken into account because the 75% test is applied based on the "properties" of the Canadian target.

The other computation required to be made in applying the 75% test in paragraph 212.3(10)(*f*) is of the total fair market value of all the shares the Canadian target corporation owns, directly or indirectly (i.e., through shareholdings of other corporations), of its foreign affiliates. This computation includes only the value of the Canadian target's proportionate equity interest in its foreign affiliates, rather than the total value of each foreign affiliate. In addition, since the parenthetical language in paragraph 212.3(10)(*f*) excludes only debts of Canadian corporations, any debts of foreign affiliates will be reflected in their share values for these purposes. Finally, where a foreign affiliate itself owns shares of another foreign affiliate of the Canadian target, such that the value of the upper-tier foreign affiliate's shares reflects that of the lower-tier affiliate, the rule against "double counting", in paragraph 212.3(14)(*b*), precludes taking the value of the lower-tier foreign affiliate into account more than once.

If the condition in paragraph 212.3(10)(*f*) is satisfied, then for the purposes of subsection 212.3(2), the CRIC will be considered to have made a separate investment in a subject corporation for each foreign affiliate of the Canadian target corporation (all of which were indirectly acquired by the CRIC). As noted above in the commentary on subsection 212.3(2), the CRIC must reasonably allocate the consideration paid for the Canadian target corporation to the foreign affiliate shares in order to determine the appropriate consequences under subsection 212.3(2).

Even if the condition in paragraph 212.3(10)(*f*) is not met at the time of the CRIC's investment in the Canadian target, paragraph 212.3(14)(*a*) will deem it to have been met at that time if property of the Canadian target corporation is subsequently disposed of as part of the same series of transactions as the investment. For further information, see the commentary on paragraph 212.3(14)(*a*) below.

By virtue of paragraph 212.3(10)(*g*), an investment for purposes of section 212.3 includes an acquisition by a CRIC of an option or interest in respect of either shares or debt (other than the kinds of debt excepted from the definition of investment under any of subparagraphs 212.3(10)(*c*)(i), (*c*)(ii), (*d*)(i) and (*d*)(ii)) of a subject corporation. The reference to an "interest" in this paragraph is not intended to include, in and of itself, an acquisition by a CRIC of shares of another Canadian corporation that itself holds shares or debt of a subject corporation.

Example (212.3(10)(f))

Assumptions

- *NR Co, a non-resident corporation, owns all the shares of Canco 1, a corporation resident in Canada. Canco 1 has excess cash that it uses to acquire all the shares of Canco 2, a Canadian-resident corporation that deals at arm's length with Canco 1 at all times prior to the acquisition, for $18 million.*
- *Canco 2's assets consist of business assets, with an aggregate fair market value of $3 million, and all of the shares of Canco 3, another corporation resident in Canada whose shares have an aggregate fair market value of $15 million.*
- *Canco 3's assets consist of:*
  - *Canadian business assets, with an aggregate fair market value of $2 million;*
  - *all of the shares of FA 1, a foreign affiliate of Canco 3; and*
  - *50% of the shares of FA 2, another foreign affiliate of Canco 3.*
- *Canco 3 has debt obligations payable in an aggregate amount of $2 million.*
- *The fair market value of all the shares of FA 1 is $8 million. FA 1's assets consist of business assets with an aggregate fair market value of $7 million, and all of the shares of FA 3, which have a fair market value of $1 million. FA 3 itself has business assets with a fair market value of $1 million and no liabilities.*
- *The fair market value of all the shares of FA 2 is $14 million. FA 2 has business assets with an aggregate fair market value of $18 million, and debts in an aggregate amount of $4 million. The other 50% of FA 2's shares is held by an arm's length person.*
- *None of FA 1, FA 2 or FA 3 satisfies the conditions for the exception in subsection 212.3(16).*

Analysis

Part A

- *In this example, Canco 1 has, by acquiring the shares of Canco 2, indirectly acquired the shares of FA 1, FA 2 and FA 3. In order to determine whether subsection 212.3(2) applies to these acquisitions, it is necessary to test whether the acquisition by Canco 1 of the shares of Canco 2 satisfies the condition in paragraph 212.3(10)(f).*
- *Paragraph 212.3(10)(f) requires a comparison between, on the one hand, the total fair market value of all the foreign affiliate shares owned, directly or indirectly, by Canco 2 and, on the other hand, the total fair market value (determined without reference to debt obligations of any Canadian corporation in which Canco 2 has a direct or indirect interest) of all the properties owned by Canco 2. It is necessary to first determine the aggregate fair market value of all the shares Canco 2 owns, directly or indirectly, in its foreign affiliates. In this case, Canco 2 owns, indirectly through Canco 3, 50% of the shares of FA 2, with a fair market value of $7 million (i.e., 50% of the $14 million total fair market value of all the shares of FA 2). Canco 2 also owns indirectly all of the shares of FA 1, with a fair market value of $8 million. Although Canco 2 also owns indirectly all of the shares of FA 3, because the value of such shares is reflected in the value of the shares of FA 1, and is thus already taken into account once, the rule against "double counting", in paragraph 212.3(14)(b) (discussed below), ensures that the value of the shares of FA 3 is not taken into account separately. Thus, the total fair market value of all the foreign affiliate shares that are owned, directly or indirectly, by Canco 2 is $15 million.*

- *It is then necessary to determine the aggregate fair market value of all the properties owned (i.e., directly) by Canco 2. In this case, Canco 2 owns business assets worth $3 million. In addition, Canco 2 owns all the shares of Canco 3, which have a fair market value of $15 million. However, for the purposes of the test in paragraph 212.3(10)(f), the value of the Canco 3 shares is to be determined without taking into account Canco 3's debts of $2 million, by virtue of the parenthetical language in that paragraph. Accordingly, the value of the Canco 3 shares for these purposes is $17 million. Therefore, the total fair market value of all of Canco 2's properties for these purposes is $20 million.*
- *Based on the foregoing, the condition in paragraph 212.3(10)(f) will not be met in the case of Canco 1's acquisition of the shares of Canco 2 because the total fair market value of all of the foreign affiliate shares owned, directly or indirectly, by Canco 2 ($15 million) does not exceed 75% of the total fair market value of all of the properties owned by Canco 2 ($20 million). As a result, Canco 1's indirect acquisitions of the foreign affiliates of Canco 2 will not constitute "an investment in a subject corporation made by a CRIC" under subsection 212.3(10) and subsection 212.3(2) will not apply.*

Part B

- *If, on the other hand, it were assumed that the foreign affiliates in this case were worth $1 more, the 75% threshold in paragraph 212.3(10)(f) would be exceeded and Canco 1's indirect acquisitions of each of FA 1, FA 2 and FA 3 would constitute separate investments in a subject corporation by a CRIC to which subsection 212.3(2) would apply.*
- *In that case, for the purposes of subsection 212.3(2), and assuming that the debt obligations of Canco 3 are not specifically attributable to any particular assets of Canco 3, the portion of the $18 million purchase price paid by Canco 1 for the acquisition of Canco 2 that could reasonably be considered to relate to Canco 1's investment in FA 1 would be approximately $6.18 million ($7.0 million less $0.82 million, the pro-rata portion of Canco 3's debt attributable to FA 1); to Canco 1's investment in FA 2 would be approximately $6.18 million ($7.0 million less $0.82 million, the pro-rata portion of Canco 3's debt attributable to FA 2); to Canco 1's investment in FA 3 would be approximately $0.88 million ($1.0 million less $0.12 million, the pro-rata portion of Canco 3's debt attributable to FA 3); and to Canco 3's Canadian business assets would be approximately $1.76 million ($2.0 million less $0.24 million, their pro-rata portion of Canco 3's debt).*
- *Thus, approximately $13.24 million of the $18 million total purchase price paid would be attributable to the foreign affiliates, and the other $4.76 million would be attributable to the business assets of Canco 2 ($3 million) and Canco 3 ($1.76 million). (Note that the result would generally be no different if the purchase price allocation to the foreign affiliate shares were instead made on the basis that FA 3's value was included in the value of the FA 1 shares, rather than ascribing separate values to FA 1 and FA 3.) Thus, under paragraph 212.3(2)(a), Canco 1 would be deemed to pay a dividend to NR Co in the amount of approximately $13.24 million.*

Pertinent loan or indebtedness

ITA
212.3(11)

New subsection 212.3(11) of the Act defines "pertinent loan or indebtedness", at any time, for the purposes of subparagraphs 212.3(10)(*c*)(ii), (*d*)(ii) and (*e*)(i), as an amount owing, at that time, by a subject corporation to a CRIC where certain conditions are met.

There are two general categories of pertinent loans or indebtedness under subsection 212.3(11). The first category is amounts that become owing after March 28, 2012, and thus meet the condition in subparagraph 212.3(11)(*a*)(i). In order for such an amount owing to be a pertinent loan or indebtedness, the condition in subparagraph 212.3(11)(*c*)(i) must also be satisfied, by the CRIC and the parent filing a joint election in respect of that amount owing by the filing-due date of the CRIC for the taxation year in which the amount became owing.

The second category is debt obligations that became owing before March 29, 2012 and to which paragraph 212.3(10)(*e*) would otherwise apply (i.e., absent the election to treat the debt obligation as a pertinent loan or indebtedness), as a result of an extension of the term of the debt obligation, at any time before the time when the pertinent loan or indebtedness status is tested. Such a debt obligation will be a pertinent loan or indebtedness if the CRIC and the parent elect in respect of that amount owing before the filing-due date of the CRIC for the taxation year in which the maturity date for the debt obligation is extended.

In order for an amount owing that falls in either category to qualify as a pertinent loan or indebtedness, it must also satisfy the condition in paragraph 212.3(11)(*b*) that it not be described in either subparagraph 212.3(10)(*c*)(i) or (*d*)(i) – as these provide their own exceptions from subsection 212.3(2). The pertinent loan or indebtedness regime will not be available where subsection 17.1(3) applies, as discussed above. The result of being a “pertinent loan or indebtedness” is that such debts, instead of being subject to subsection 212.3(2), will be subject to the interest imputation rule set out in subsection 17.1(1), discussed above.

Late-filed elections and penalty

ITA
212.3(12) and (13)

New subsection 212.3(12) of the Act provides a three-year window for late-filing elections referred to in subsection 212.3(3) (in respect of dividend substitutions) and paragraph 212.3(11)(*c*) (in respect of pertinent loans or indebtedness). There is no ministerial discretion – the late-filing provision applies automatically, provided the CRIC pays a penalty, as set out in new subsection 212.3(13), equal to $100 per month, or part thereof, that the filing is late.

Rules for paragraph (10)(*f*)

ITA
212.3(14)

New subsection 212.3(14) of the Act provides two rules for applying the “indirect acquisition” rule in paragraph 212.3(10)(*f*). Paragraph 212.3(14)(*a*) provides an anti-avoidance rule that effectively extends the time for applying the 75% test in paragraph 212.3(10)(*f*) to the entire series of transactions that includes the acquisition of the Canadian target shares by the CRIC. Even if the condition in paragraph 212.3(10)(*f*) is not satisfied because the 75% threshold is not exceeded at the time of the acquisition, paragraph 212.3(14)(*a*) deems the condition to have been satisfied at that time if properties of the Canadian target corporation are subsequently disposed of as part of the series of transactions that includes the acquisition and such dispositions cause the 75% threshold to be exceeded at any time in the series. This rule is meant to address situations where, for example, the CRIC intends, at the time of the purchase, to retain the foreign affiliate investments while divesting itself of the Canadian business assets of the Canadian target corporation. The rule is also meant to address situations where the Canadian target, in anticipation of its acquisition by the CRIC, “stuffs” itself with non-foreign affiliate assets that have no long-term use in the company and will be disposed of shortly after the acquisition.

The second rule is found in paragraph 212.3(14)(*b*) and is a rule against “double counting” in applying the 75% test in paragraph 212.3(10)(*f*). In computing the total fair market value of all the foreign affiliate shares owned directly or indirectly by the Canadian target, if a foreign affiliate itself owns shares of another foreign affiliate of the Canadian target such that the value of the upper-tier foreign affiliate’s shares reflects that of the lower-tier affiliate, paragraph 212.3(14)(*b*) precludes the value of the lower-tier foreign affiliate’s shares from being taken into account separately. In effect, this rule is meant to achieve a form of consolidation for the purposes of the indirect acquisition rule.

Control

ITA
212.3(15)

New subsection 212.3(15) of the Act provides special rules for determining control, for the purposes of section 212.3 and the corporate immigration rule in paragraph 128.1(1)(*c.3*).

Paragraph 212.3(15)(*a*) provides that a CRIC that is controlled by more than one non-resident corporation is deemed not to be controlled by any such corporation that controls another non-resident corporation that controls the CRIC – unless the application of this deeming rule would result in the CRIC not being controlled by any non-resident corporation.

Paragraph 212.3(15)(*a*) is a relieving provision. It is intended to prevent multiple dividends from being deemed under subsection 212.3(2) or paragraph 128.1(1)(*c.3*). Multiple dividends could otherwise arise under subsection 212.3(2) due to the fact that paragraph 212.3(2)(*a*) deems the CRIC to have paid a dividend to the "parent", which is defined in paragraph 212.3(1)(*b*) to mean any non-resident corporation that controls the CRIC at the time of the investment. Consequently, in the absence of paragraph 212.3(15)(*a*), where more than one non-resident corporation controls the CRIC (for example where a non-resident public company owns another non-resident corporation that, in turn, owns the CRIC), paragraph 212.3(2)(*a*) could deem a separate dividend to have been paid to each such non-resident. Similarly, in the absence of paragraph 212.3(15)(*a*), multiple dividends could be deemed under paragraph 128.1(1)(*c.3*) in similar circumstances since that paragraph deems an immigrating corporate taxpayer to have paid a dividend to a "particular non-resident corporation", which term refers to any non-resident corporation that controls the CRIC.

Paragraph 212.3(15)(*a*) applies unless its application would result in the CRIC not being controlled by at least one non-resident corporation. This exclusion addresses situations where corporate groups organize themselves so that all non-resident "controllers" control each other.

Paragraph 212.3(15)(*b*) is also a relieving provision. It applies where a CRIC is controlled by a non-resident corporation, and the non-resident corporation is ultimately controlled by a Canadian-resident corporation and not by any non-resident. In these circumstances, the CRIC will be deemed not to be controlled by a non-resident. As a consequence, the conditions of subsection 212.3(1) will not be met and the foreign affiliate dumping rules will not apply to the CRIC.

Exception – more closely connected business activities

ITA
212.3(16)

New subsection 212.3(16) of the Act provides an exception from the operative foreign affiliate dumping rule in subsection 212.3(2). This exception generally recognizes that certain foreign affiliate investments made by foreign-controlled CRICs may have been made by the CRIC even if the CRIC had not been foreign-controlled. The exception is intended to allow a Canadian subsidiary of a foreign multinational corporation to invest in foreign affiliates in certain circumstances where the Canadian subsidiary is making a strategic acquisition of a business that is more closely connected to its business than to that of any non-resident member of the multinational group.

The CRIC is required to demonstrate that the conditions in subsection 212.3(16), as described below, are met. Thus, the onus is on the CRIC to establish these facts. Also, the exception will not be available where the shares acquired are what are commonly referred to as "preferred shares". The "preferred shares" carve-out is discussed in the commentary on subsection 212.3(19), below.

The exception applies where five conditions are met. The first condition, in paragraph 212.3(16)(*a*), generally requires that the business activities of the subject corporation, and any corporation (referred to in subsection 212.3(16) and in this commentary as a "subject subsidiary corporation") in which the subject corporation has an equity percentage, be, collectively, more closely connected to the business activities carried on by the CRIC (or a Canadian-resident corporation that does not deal at arm's length with the CRIC) in Canada than to those of any other non-resident corporation that does not deal at arm's length with the CRIC (other than the subject corporation, a subject subsidiary corporation and any corporation that is a controlled foreign affiliate (CFA) of the CRIC for the purposes of section 17). For these purposes, "business activities" is intended to refer to active business operations rather than simply investing in shares in other companies and the management and governance activities that may relate thereto.

The concept of "connectedness" is not defined, but for the purposes of these rules it is intended that the business activities of two corporations be considered "connected" in either of two circumstances. First, business activities can be considered connected where they are similar in nature or "parallel". For example, two businesses could be closely connected where they both involve the manufacture and distribution of similar types of products, or the provision of similar services. Second, business activities can be considered connected where they are integrated, in the sense of one corporation's business being "upstream" or "downstream" to the business of the other corporation, or in the sense of one business using technology of the other in its operations. Thus, for example, two corporations could be considered to have connected business activities if the primary activity of one corporation consists of selling the output of, or providing inputs to, the manufacturing process of the other corporation. In each case, the question is whether the businesses are connected in a manner indicative of the investment in the subject corporation being a logical expansion of the CRIC's business.

In order for the condition in paragraph 212.3(16)(*a*) to be satisfied, it is not sufficient that the CRIC's and the subject corporation's businesses be connected or even closely connected – the businesses must be more closely connected to one another than the subject corporation's business is to the business of any other non-resident corporate group member (other than the subject corporation, a subject subsidiary corporation or a CFA). Thus, this condition would not be met where, for example, the subject corporation's business is equally closely connected to that of the CRIC as it is to that of another non-resident group member (other than a subject subsidiary corporation or a CFA). This requirement reflects the intention that the exception from subsection 212.3(2) apply only where the relationship between the CRIC's and the subject corporation's businesses clearly justify the investment in the subject corporation being made by the CRIC rather than by another member of the multinational group.

Paragraph 212.3(16)(*a*) further requires that the parties have an expectation, at the time of the investment, that the closer business connection described above will continue for the foreseeable future. This requirement acts as a check to ensure that the connection to Canada is not temporary or contrived.

The second condition, in paragraph 212.3(16)(*b*), is that officers of the CRIC must have had and exercised the principal decision-making authority in respect of the making of the investment and a majority of those officers must be persons that are resident, and work principally, in Canada or the residence country of a "connected affiliate" (defined in paragraph 212.3(16)(*b*) to mean a corporation that is a CFA whose business activities are, and are expected to remain, at least as closely connected to those of the subject corporation and subject subsidiary corporations as are the Canadian business activities of the CRIC or any Canadian-resident corporation that does not deal at arm's length with the CRIC) at the time the investment is made. For these purposes, subsection 212.3(17) provides that any person that is an officer of the CRIC and of a non-resident corporation that does not deal at arm's length with the CRIC (other than the subject corporation, a subject subsidiary corporation or a connected affiliate) is deemed to not be resident, and to not work principally, in a country in which a connected affiliate is resident. The condition in paragraph 212.3(16)(*b*) will be satisfied only where the relevant officers have the decision-making authority and actually exercise such authority. Where this is the case, the CRIC would be, in this respect, acting in a manner similar to a Canadian (non-foreign controlled) multinational corporation undertaking a strategic foreign expansion of its business.

The reference in paragraph 212.3(16)(*b*) to "principal" decision-making authority is intended to ensure that this condition will be met only where substantive responsibility for the decision to make the investment, and with respect to the terms of the investment, rests with and is exercised by relevant officers of the CRIC. Where the CRIC's officers have and exercise only formal authority to approve the investment, but the real decision-making authority with respect to the making of the investment resides with officers of a non-resident corporation, then this condition will not be met. Similarly, where the formal decision-making authority with respect to an investment in a foreign affiliate made by a CRIC is exercised by officers or directors of the non-resident parent of the CRIC, the condition could still be met if, for example, the substantive business decisions with respect to the investment are made by the relevant officers of the CRIC, based on their execution of the business plan of the CRIC and having undertaken or managed all of the commercial and investment due diligence relating to the acquisition or investment in the subject corporation.

The officers will be considered to work principally in Canada, or in the residence country of a connected affiliate, if they spend the majority of their working time in Canada or the connected affiliate's country, and also carry out a majority of their important functions, and make most of their important decisions, with respect to the CRIC in that country.

The third and fourth conditions, in subparagraphs 212.3(16)(*c*)(i) and (ii), are that, at the time the investment is made, there must be a reasonable expectation that, at all times following the time of the investment, officers of the CRIC will have and exercise the ongoing principal decision-making authority in respect of the investment and that a majority of those officers will be persons that are residents of, and work principally in, Canada or the residence country of a connected affiliate. This requirement will be met only where the relevant CRIC officers are expected to have and exercise the principal authority in respect of the key decisions concerning the ongoing investment in the subject corporation. The particular matters over which they would be expected to hold and exercise such authority would generally depend on the relative size and nature of the CRIC's investment in the subject corporation. For example, where the CRIC owns a controlling interest in the subject corporation, the range of matters in respect of the subject corporation over which the CRIC's officers can be expected to exercise principal decision-making authority will be greater than where the CRIC does not own a controlling interest in the subject corporation. The commentary on paragraph 212.3(16)(*b*) above, regarding the nature of the decision making authority expected of the officers of the CRIC, is also relevant for subparagraph 212.3(16)(*c*)(i).

The fifth condition, in subparagraph 212.3(16)(*c*)(iii), is that it must reasonably be expected, at the time of the investment, that the performance evaluation and compensation of officers of the CRIC (who are resident, and work principally, in Canada or in the residence country of a connected affiliate) will be based on the operating results of the subject corporation to a greater extent than will be the performance evaluation and compensation of any officer of another non-resident group member (other than the subject corporation, a corporation controlled by the subject corporation or a connected affiliate). The extent to which an officer's performance evaluation or compensation is based on operating results would generally be expected to be determined based on a proportion of the officer's overall performance or compensation. Thus, where, for example, officers of the CRIC and officers of the non-resident parent corporation both receive comparable bonus amounts that are linked (e.g., by a compensation formula) to the performance of the subject corporation, the compensation of the CRIC's officers may nevertheless be considered to be connected to the subject corporation's results to a greater extent than that of the parent's officers if such bonuses constitute a greater proportion of the overall compensation of the former than of the latter.

As discussed above, it is expected that an officer's performance evaluation and compensation will reflect, to some extent, the operating results of the subject corporation. The extent to which the operating results of the subject corporation affect the performance evaluation and compensation of an officer would depend on the relative size and complexity of the subject corporation's operations and the level of responsibility the officer has over those operations. Where the CRIC acquires control of the subject corporation in circumstances where the investment in the subject corporation constitutes a strategic expansion of the CRIC's business, it is expected that the relevant officers of the CRIC would have a high level of responsibility over the subject corporation's operations and that a greater proportion of their compensation would be based on the operations of the subject corporation than any other officer's compensation in the multinational group. The same expectation exists where the CRIC does not have or acquire control of the subject corporation but the subject corporation is controlled by the multinational group of which the CRIC is a member.

For a discussion of the requirement that the relevant officers be “resident, and work principally, in Canada”, see the commentary on paragraph 212.3(16)(*b*) above.

Example 1 – foreign-controlled Canadian manufacturer

If commercial aircraft are manufactured by the CRIC and its non-resident parent company, the closer business connection condition in paragraph 212.3(16)(a) would not likely be met if the CRIC were to purchase a non-resident corporation that is a competing commercial aircraft manufacturer. In that case, the business activities of the acquired company would likely be no more closely connected to those of the CRIC than to those of the non-resident parent.

If, however, the CRIC were the only company in the multinational group that manufactures military aircraft, then the closer business connection condition in paragraph 212.3(16)(a) may well be satisfied were the CRIC to purchase a non-resident corporation that was a competing military aircraft manufacturer.

Example 2 – foreign-based private equity fund

If a foreign-based private equity (“PE”) fund acquired a Canadian operating company (the “CRIC”), the PE fund is managed by its foreign-based general partner (“GP”), the CRIC is controlled by the GP, the CRIC is a portfolio company of the PE fund (i.e., the CRIC is the parent of a group of companies all of which carry on a particular type of business and is the entity that would be sold or taken public), and the CRIC either owns foreign affiliates that require funding or expands internationally through the acquisition of foreign affiliates, the exception may be available with respect to investments in foreign affiliates made by the CRIC. In these circumstances, it may be reasonable to expect that the business of any foreign affiliate in which the CRIC makes an investment would be more closely connected to the CRIC than to any business carried on by the GP or any other portfolio company in the group. In addition, provided the CRIC had stand-alone executive management whose performance and compensation was determined exclusively by reference to the performance of the multinational group of which the CRIC was the parent, then it would also be reasonable to expect that the decision making elements of the exception would be satisfied. In particular, the nature of the oversight exercised by the GP would not normally be considered to displace the decision making authority of the officers of the CRIC for purposes of this exception. This reflects the normal role of a GP as an owner (and manager of portfolio companies), separate and distinct from the governance and management of the CRIC.

If, however, the PE fund also owned, for example, a non-resident corporation in a business similar to the CRIC and if the CRIC was operationally a part of a group that included such non-resident corporation (whether or not the CRIC was a subsidiary of the non-resident corporation), in applying this exception, regard must be given to whether the business activities of any foreign affiliates of the CRIC, in which the CRIC makes an investment, are more closely connected to the CRIC than to the non-resident corporation and to whether any officers of such non-resident corporation exercised decision making control over the CRIC. If the business activities of the foreign affiliates in which the CRIC made investments were as or more closely connected with the non-resident corporation, or officers of the non-resident corporation in effect controlled the decision making of the CRIC, this exception would not apply.

Dual officers

ITA
212.3(17)

New subsection 212.3(17) of the Act provides a deeming rule that precludes officers of the CRIC who are also officers of certain non-resident corporate group members from “counting” towards the majority required, for the purposes of paragraphs 212.3(16)(*b*) and (*c*), to be resident and working principally either in Canada or in the country of residence of a connected affiliate (as defined in subparagraph 212.3(16)(*b*)(ii)). More specifically, subsection 212.3(17) excludes for such purposes any officer of a non-resident corporation with which the CRIC, at the investment time, does not deal at arm’s length (other than the subject corporation, a subject subsidiary corporation or a connected affiliate), by deeming such officer to not be resident, and to not work principally, in a country in which a connected affiliate is resident.

Exception – corporate reorganizations

ITA
212.3(18)

New subsection 212.3(18) of the Act provides a number of exceptions to the foreign affiliate dumping rules for various forms of corporate reorganizations and distributions that result in the direct or indirect acquisition of shares of a subject corporation by a CRIC. The underlying premise for these exceptions is that if no incremental value is being transferred from a CRIC to a subject corporation, subsection 212.3(2) should not apply. However, a subset of these exceptions (found in paragraphs 212.3(18)(*b*) and (*d*)) will not apply to transactions involving what are commonly referred to as "preferred shares", notwithstanding that no incremental value may be transferred. The "preferred shares" carve out is discussed in the commentary on subsection 212.3(19), below.

Subparagraph 212.3(18)(*a*)(i) deals with acquisitions of foreign affiliate shares by one Canadian-resident corporation from another. Where the two companies are related at the time of the acquisition, subsection 212.3(2) will not apply unless the companies deal at arm's length at any time before the acquisition and within the series of transactions that includes the acquisition. This paragraph is intended to cover, among other things, situations where foreign affiliate shares are transferred by a Canadian corporation on a winding up into its Canadian-resident parent (subject to the arm's length/series test). Whether the two companies are related and deal at arm's length is to be determined without regard to rights referred to in paragraph 251(5)(*b*).

Subparagraph 212.3(18)(*a*)(ii) is virtually identical to subparagraph 212.3(18)(*a*)(i) but applies to acquisitions of foreign affiliate shares by a CRIC that is formed on the amalgamation of two or more Canadian-resident corporations.

Paragraph 212.3(18)(*b*) lists a number of exceptions relating to share-for-share transactions at the foreign affiliate level and certain distributions made by a foreign affiliate. In this regard, the exceptions will only apply to foreign affiliate shares that are received – subsection 212.3(2) is intended to apply to the extent that debt or other forms of non-share consideration are also received as a result of the share-for-share or distribution transaction. As noted above, these exceptions do not apply to "preferred share" acquisitions, as set out in subsection 212.3(19). Also, regard must be had to subsection 212.3(20) for distributions described in subparagraphs 212.3(18)(*b*)(v) to (vii). For further information, see the commentary below on subsection 212.3(20).

Paragraph 212.3(18)(*c*) provides exceptions for internal reorganizations that involve an indirect acquisition of shares of a subject corporation by a CRIC, described in paragraph 212.3(10)(*f*), resulting from a direct acquisition by the CRIC of shares of another corporation resident in Canada. Subparagraphs 212.3(18)(*c*)(i) and (ii) are analogous to subparagraphs 212.3(18)(*a*)(i) and (ii), respectively, in that they provide exceptions for indirect acquisitions of foreign affiliate shares by one Canadian-resident corporation from another, where similar conditions are satisfied. Subparagraphs 212.3(18)(*c*)(iii) and (iv) are similar to subparagraphs 212.3(18)(*b*)(i) and (iii), respectively, and provide exceptions for exchanges and reorganizations under subsections 51(1) and 86(1), respectively, of shares of a Canadian-resident corporation that are held by a CRIC, which result in an indirect acquisition by the CRIC of foreign affiliate shares.

Subparagraph 212.3(18)(*c*)(v) provides an exception that is intended to prevent subsection 212.3(2) from applying more than once, in certain circumstances, where funds are transferred through tiers of Canadian corporations and invested in a foreign affiliate. More specifically, this subparagraph provides that subsection 212.3(2) does not apply to an investment that is an indirect acquisition of shares of a subject corporation by a CRIC (to which paragraph 212.3(10)(*f*) applies), resulting from a direct acquisition by the CRIC of shares of another Canadian-resident corporation, if the other Canadian-resident corporation (or a particular Canadian-resident corporation related to the CRIC and the other corporation) in turn uses the property transferred by the CRIC to make a direct investment in a subject corporation (i.e., not one to which paragraph 212.3(10)(*f*) applies). In order to qualify for this exception, the relevant investments must occur within 30 days of each other and as part of the same series of transactions or events.

Paragraph 212.3(18)(*d*) prevents subsection 212.3(2) from applying where debt is exchanged for equity and is intended to supplement the rules in subparagraphs 212.3(18)(*b*)(i) and (*c*)(iii) that deal with subsection 51(1) conversions of debt into equity. In contrast to subsection 51(1), paragraph 212.3(18)(*d*) does not require that a conversion feature exist in the terms of the debt instrument.

Preferred shares

ITA
212.3(19)

New subsection 212.3(19) of the Act provides that the exceptions in subsection 212.3(16) and paragraphs 212.3(18)(*b*) and (*d*) are not available in respect of a CRIC's acquisition of shares of a subject corporation if the CRIC does not have a fully participating equity interest in the subject corporation. In other words, the exceptions are not available where the CRIC acquires what are commonly referred to as "preferred shares".

For the purposes of subsection 212.3(19), the determination of whether the shares acquired by the CRIC fully participate in the profits of the subject corporation and any appreciation in the value of the subject corporation is to be made having regard to all the terms and conditions of the shares themselves and any agreement in respect of the shares. However, even if the shares of the subject corporation acquired by the CRIC are less than fully participating, subsection 212.3(19) further provides that this fact will not preclude the availability of the exceptions in subsection 212.3(16) and paragraphs 212.3(18)(*b*) and (*d*) if the subject corporation is a "subsidiary wholly-owned corporation" of the CRIC, as defined in subsection 248(1). For the subject corporation to be a "subsidiary wholly-owned corporation", the CRIC, together with certain subsidiary wholly-owned corporations of the CRIC and corporations of which the CRIC is a subsidiary wholly-owned corporation, must own all of its shares (except directors' qualifying shares). Thus, if this requirement is met, the CRIC would be considered to have a fully participating interest in any preferred shares of the subject corporation that the CRIC acquires.

For these purposes, it is intended that the existence of preferred shares, in and by itself, would not preclude a CRIC that acquires common shares from being considered to have acquired fully participating shares.

Assumption of debt on liquidation or distribution

ITA
212.3(20)

New subsection 212.3(20) of the Act overrides the rules in subparagraphs 212.3(18)(*b*)(v) to (vii) – which otherwise except certain foreign affiliate distributions from the rule in subsection 212.3(2) – by making subsection 212.3(2) apply to an acquisition by a CRIC of foreign affiliate shares on such a distribution to the extent of any debt assumed by the CRIC in respect of the distribution. Subparagraphs 212.3(18)(*b*)(v) to (vii), taken together, provide that subsection 212.3(2) does not apply to an acquisition of shares of a subject corporation by a CRIC where those shares are acquired on any of the following three types of transactions:

- a liquidation and dissolution of a foreign affiliate to which subsection 88(3) applies;
- a redemption of the shares of another foreign affiliate of the CRIC; or
- a dividend or reduction of paid-up capital in respect of the shares of another foreign affiliate of the CRIC.

However, where a top-tier foreign affiliate is liquidated into a CRIC, and the shares of a lower-tier foreign affiliate are distributed to the CRIC in a transaction to which subsection 88(3) applies, the CRIC might in certain cases assume debt of the top-tier affiliate. Similarly, where the top-tier foreign affiliate distributes shares of a lower-tier affiliate to the CRIC, either on a redemption of shares or as a dividend or reduction of paid-up capital, the CRIC might assume debt of the top-tier affiliate in respect of the distributed shares. In all of the foregoing situations, where debt is assumed by the CRIC, paragraph 212.3(20) will cause subsection 212.3(2) to apply to the acquisition by the CRIC of the shares of the lower-tier foreign affiliate to the extent of the value of the debt assumed.

Persons deemed not to be related

ITA
212.3(21)

New subsection 212.3(21) of the Act contains an anti-avoidance rule, similar to the rule in subsection 55(4), that deems persons to be unrelated for the purposes of the reorganization exceptions in subsection 212.3(18) if it can reasonably be considered that one of the main purposes of one or more transactions or events was to cause those persons to be related so that one of those exceptions would apply.

Mergers

ITA
212.3(22)

For the purposes of section 212.3 and subsections 219.1(3) and (4) of the Act, subsection 212.3(22) provides "continuity" rules – similar to the rules in subsections 87(1.2) and 88(1.5), among other provisions – that apply to amalgamations under subsection 87(11) and windings-up under subsection 88(1). It also contains complementary deeming rules that effectively exclude from the application of the rule in subsection 212.3(2) acquisitions by a CRIC of foreign affiliate shares resulting from a merger to which subsection 87(11) or 88(1) applies.

Indirect investment

ITA
212.3(23)

New subsection 212.3(23) of the Act is an anti-avoidance rule targeted at situations where a CRIC uses a "good" foreign affiliate as a conduit to make an investment in a "bad" foreign affiliate. A "good" foreign affiliate would be a subject corporation an investment in which, by the CRIC, would satisfy the exception in subsection 212.3(16); an investment by the CRIC in a "bad" foreign affiliate would not satisfy that exception. More specifically, subsection 212.3(23) provides that subsection 212.3(2) applies to an investment by a CRIC in a subject corporation where the subject corporation may reasonably be considered to have used, directly or indirectly as part of a transaction or event or series of transactions or events that includes the investment, a property it received from the CRIC (or any property substituted for such property) to make an investment in a non-resident corporation to which subsection 212.3(2) would have applied had the investment been made directly by the CRIC. Thus, subsection 212.3(23) can apply to, effectively, override subsection 212.3(16).

Indirect funding

ITA
212.3(24)

New subsection 212.3(24) of the Act generally provides an exception from subsection 212.3(2) that applies, in certain circumstances, where a CRIC funds one foreign affiliate indirectly through another foreign affiliate, and the exception in subsection 212.3(16) would have applied had the CRIC instead funded the other foreign affiliate directly. In order for an investment in a subject corporation by a CRIC to qualify for the exception in subsection 212.3(24), the CRIC must demonstrate three things. First, under paragraph 212.3(24)(*a*), the CRIC must demonstrate that all of the property received by the subject corporation as a result of the CRIC's investment was used, at a particular time that is within 30 days after the time the investment was made and at all times after the particular time, by the subject corporation to make a loan to a controlled foreign affiliate (as defined in section 17). Second, under paragraph 212.3(24)(*b*), throughout the portion of the period during which the series of transactions that includes the making of the inter-affiliate loan occurs that is after the investment time, the corporation that is being indirectly funded must be a corporation in which a direct investment by the CRIC would have qualified for the exception in subsection 212.3(16). Finally, under paragraph 212.3(24)(*c*), the CRIC must demonstrate that, throughout the period during which the loan is outstanding, the indirectly funded corporation used the loan proceeds in an active business that it carried on in its country of residence.

Partnerships

ITA
212.3(25)

New subsection 212.3(25) of the Act contains "look-through" rules for partnerships for the purposes of the foreign affiliate dumping rules in section 212.3, the immigration and emigration rules in paragraphs 128.1(1)(*c.3*) and subsection 219.1(2), respectively, and subsection 17.1(1), as it applies in respect of "pertinent loans and indebtedness" referred to in subsection 212.3(11).

For those purposes, paragraph 212.3(25)(*a*) deems each member of a partnership to have entered into any transaction entered into by the partnership itself, in proportion to the fair market value of the member's direct and indirect (i.e., held through other partnerships) interests in the partnership. Therefore, where a CRIC is a member of a partnership that enters into any of the transactions described in paragraphs 212.3(10)(*a*) to (*g*), the CRIC is deemed to enter into the partnership's transaction, which would generally result in the CRIC being considered to have made an investment in a subject corporation. The reference in paragraph 212.3(25)(*a*) to an "event participated in" is intended to capture any event described in paragraphs 212.3(10)(*a*) to (*g*) that cannot be considered to be a transaction, which may include certain benefit conferrals described in paragraph 212.3(10)(*b*) or term extensions described in paragraph 212.3(10)(*e*).

Paragraph 212.3(25)(*b*) is similar to paragraph 212.3(25)(*a*) except that it deals with the ownership of property rather than the entering into of transactions.

Paragraph 212.3(25)(*c*) provides rules that ensure appropriate results under the foreign affiliate dumping rules where relevant events occur at the partner level, as opposed to the partnership level. In this regard, subparagraph 212.3(25)(*c*)(i) provides that, where there is an increase in the portion of a partnership property that paragraph 212.3(25)(*b*) deems a member to own, the member is deemed to acquire the additional portion of the property. This rule ensures that where there is an increase in a CRIC's proportionate interest in a partnership that owns, directly or indirectly, foreign affiliate shares, this will result in an investment by the CRIC in a subject corporation under subsection 212.3(10).

In the same circumstances, subparagraph 212.3(25)(*c*)(ii) will deem the CRIC to "transfer property that relates to the acquisition" that has a fair market value equal to the fair market value of the additional portion of the partnership property. This is intended to ensure that the investment by the CRIC in the foreign affiliate results in appropriate consequences under paragraph 212.3(2)(*a*), which deems the CRIC to pay a dividend equal to the portion of the fair market value of "property transferred" by the CRIC that can "reasonably be considered to relate to" the investment.

Paragraph 212.3(25)(*d*) is analogous to paragraphs 212.3(25)(*a*) and (*b*), except that it applies to amounts owing by a partnership.

Paragraph 212.3(25)(*e*) provides relief from the foreign affiliate dumping rules where a CRIC that is a member of a partnership transacts with the partnership. In general terms, where a transaction is between a member of a partnership and the partnership, the paragraph overrides the deeming rule in paragraph 212.3(25)(*a*) by providing that it does not apply to the extent it would otherwise have deemed the member to have entered into the transaction. For example, where a CRIC sells its shares of a foreign affiliate to a partnership of which it owns a 50% interest, paragraph 212.3(25)(*e*) will prevent paragraph 212.3(25)(*a*) from treating the CRIC as having acquired, through the partnership, 50% of those foreign affiliate shares.

Paragraph 212.3(25)(*f*) is a rule for tiered partnerships, that is, partnerships that are members of other partnerships. Specifically, the paragraph deems a person or partnership that is (or is deemed under that paragraph to be) a member of a particular partnership, that itself is a member of another partnership, to be a member of the other partnership. In other words, this rule ensures that a member of an upper-tier partnership is also considered to be a member of a lower-tier partnership of which the upper-tier partnership is a member.

Coming-into-force for section 212.3

New section 212.3 applies in respect of transactions and events that occur after March 28, 2012, with two exceptions. First, certain transactions in progress at the time these rules were first announced (March 29, 2012) are exempt, i.e., grandfathered, if they are completed before 2013 and no party to the relevant agreement may be excused from completing the transaction as a result of changes to the Act. Second, taxpayers may elect to have a version of the rule based on the March 29, 2012 Notice of Ways and Means Motion apply for transactions that occur before August 14, 2012. Also, an extension is provided for filing elections under subsections 212.3(3) and (11) if the election is required to be made before the day that is 120 days after Royal Assent.

Clause 50

Deemed dividends & deemed interest payments

ITA
214(16) and (17)

New subsections 214(16) and (17) of the Act implement the measure announced in Budget 2012 to treat interest that is not deductible because of the thin capitalization rules as a deemed dividend for the purposes of Part XIII of the Act.

Paragraph 214(16)(*a*) deems thin capitalization interest (i.e., an amount disallowed as a deduction under subsection 18(4) or an amount included in income under paragraph 12(1)(*l.1*)) of a corporation to be a dividend paid by the corporation and not to be interest for the purposes of Part XIII. For example, if an amount in respect of interest paid by a partnership is included in a corporation's income under paragraph 12(1)(*l.1*) and is then deemed to have been paid by the corporation as a dividend for Part XIII purposes, the partnership paying the interest will be deemed not to have paid the amount as interest. As a consequence, the non-resident lender will be entitled to apply for a refund of any excess withholding tax remitted by, or on behalf of, the non-resident lender.

In addition, paragraph 214(16)(*b*) allows the corporation to designate in its return of income for a taxation year which payments of interest in the year are to be recharacterized as dividends. Absent a designation, the appropriate portion of each interest payment is deemed to be a dividend.

Subsection 214(17) provides certain rules for the purposes of subsection 214(16). Paragraph 214(17)(*a*) provides that interest (other than compound interest) that is payable at the end of a corporation's taxation year to have been paid at the end of that year and not at any other time (i.e., not to have been paid or credited when it is actually paid or credited). This applies to interest that is payable by a corporation at the end of its taxation year and to interest that is payable at the end of a corporation's taxation year by a partnership of which the corporation is a member.

These amendments apply to taxation years that end after March 28, 2012. However, for taxations years that include March 29, 2012, the deemed dividend for the year is prorated based upon the number of days in the year that are after March 28, 2012.

Paragraph 214(17)(*b*) ensures that these deemed dividend rules cannot be avoided by transferring a debt obligation in the circumstances described in either subsection 214(6) or (7). Paragraph 214(17)(*b*) provides that interest that is non-deductible due to the application of the thin capitalization rules and payable by a corporation at the time of a transfer to which either subsection 214(6) or (7) applies will be deemed, for the purposes of subsection 214(16), to have been paid by the corporation to the non-resident immediately before the transfer.

This amendment applies on and after August 14, 2012.

Clause 51

Corporate emigration

ITA
219.1

Section 219.1 of the Act imposes a tax (commonly known as the “departure tax”) on a corporation that ceases to be resident in Canada. The tax is computed as 25% of the difference between the fair market value of all the property owned by the corporation at the time of emigration and the total of certain other amounts, one of which is the paid-up capital of all the shares of the corporation at the time of emigration. Pursuant to section 219.3, the 25% rate can be reduced by a tax treaty.

Section 219.1 is being expanded into five subsections, in order to address foreign affiliate dumping.

Corporate emigration

ITA
219.1(1)

New subsection 219.1(1) of the Act is essentially a renumbering of existing section 219.1, but it also contains certain modifications to modernize the language and structure of that provision.

Foreign affiliate dumping – emigrating corporation

ITA
219.1(2)

New subsection 219.1(2) of the Act contains a new rule that deems, in certain circumstances, the paid-up capital of the company to be nil, for the purposes of the departure tax calculation. New subsection 219.1(2) is added in order to deter certain corporate emigration strategies that could be used as substitutes for transactions that are addressed by the foreign affiliate dumping rules in new section 212.3.

Subsection 219.1(2) applies where any shares of the emigrating corporation are owned by a Canadian-resident corporation that is controlled by a non-resident corporation and the emigrating corporation is a foreign affiliate of the shareholder immediately after the emigration. In these circumstances, the emigration would lead to a result similar to that which the foreign affiliate dumping rules in new section 212.3 are aimed at preventing. As such, where these conditions are met, any paid-up capital (PUC) that the emigrating corporation otherwise would have is deemed to be nil, with the result that a higher departure tax will be payable by the emigrating corporation.

For the purposes of subsection 219.1(2), the look-through rules in subsections 93.1(1) and 212.3(25) apply where one or more partnerships are in the ownership structure.

Example

Assumptions

- *NR Parent, a non-resident corporation, owns all the shares of Canco 1, a Canadian-resident corporation.*
- *Canco 1 owns all the shares of Canco 2.*
- *Canco 2 is incorporated and resident in Canada at first, but it emigrates to Bermuda on May 1st, 2012.*
- *At the time of its emigration:*
    - *Canco 2 has no assets other than cash of $100 and has no liabilities; and*

- *Canco 2 has paid-up capital (PUC) of $100.*

- *Shortly after the emigration, Canco 2 uses its $100 of cash to purchase all the shares of a corporation resident in Germany from NR Parent.*

Analysis

- *Canco 1 will have achieved a foreign affiliate "dump" as Canco 2 will become a foreign affiliate of Canco 1 upon the emigration. Section 212.3 will not apply to the purchase of the German subsidiary because Canco 2 is a not a CRIC at the time of the purchase. (Also, section 212.3 will not apply to the initial investment by Canco 1 in Canco 2 because Canco 2 is not a non-resident at that time.)*
- *Subsection 219.1(2) will apply in these circumstances to eliminate Canco 2's PUC at the time of emigration such that departure tax of $25 will be payable.*

Paid-up capital reinstatement

ITA
219.1(3) to (5)

New subsections 219.1(3) to (5) of the Act are part of the foreign affiliate dumping rules that are primarily contained in new section 212.3. Subsections 219.1(3) and (4) contain rules, similar to subsection 212.3(9), that allow a corporation's PUC to be "reinstated" immediately before the corporation emigrates, where it has had a prior reduction of its PUC under paragraph 212.3(2)(*b*) or (7)(*b*). The result of such a PUC reinstatement is a reduction of the "departure tax" otherwise payable by an emigrating corporation under subsection 219.1(1).

Subsection 219.1(3) provides the conditions for the application of subsection 219.1(4). The first condition, in paragraph 219.1(3)(*a*) is, simply, that the corporation must cease to be resident in Canada. The second condition, in paragraph 219.1(3)(*b*), is that, prior to the corporation's emigration, its PUC must have been reduced under paragraph 212.3(2)(*b*) or (7)(*b*) as a result of an investment made by a CRIC in a subject corporation that is one of the types of investments described in paragraph 212.3(10)(*a*) (an acquisition of subject corporation shares), 212.3(10)(*b*) (a capital contribution to a subject corporation) or 212.3(10)(*f*) (an indirect acquisition of shares of a subject corporation resulting from a direct acquisition of shares of a Canadian-resident corporation). The third condition, in paragraph 219.1(3)(*c*), is that no PUC in respect of any class of shares of the emigrating corporation, or a specified predecessor corporation (as defined in subsection 95(1)) of the emigrating corporation, have been previously reinstated under subsection 212.3(9). Finally, paragraph 219.1(3)(*d*) requires that subsection 219.1(2) not be applicable in respect of the emigration.

If subsection 219.1(4) applies, the PUC in respect of the shares of the emigrating corporation is increased – two instants before the emigration time – for purposes of paragraph (*a*) of variable B in the formula in subsection 219.1(1), by the lesser of two amounts. The first amount is the total of all prior PUC reductions under paragraph 212.3(2)(*b*) or (7)(*b*) in respect of a class of shares of the emigrating corporation in connection with an investment described in paragraph 212.3(10)(*a*), (*b*) or (*f*). The second amount is the aggregate fair market value of shares of subject corporations that are owned by the emigrating corporation immediately before the emigration, or the portion of the fair market value of any foreign affiliate shares that are owned by the emigrating corporation and that were substituted for shares of a subject corporation.

Subsection 219.1(5) is a definitional provision that imports into subsections 219.1(3) and (4) the meaning of the terms "CRIC", "subject corporation" and "investment" from the foreign affiliate dumping rules in section 212.3.

The amendments to section 219.1 apply to corporate emigrations that occur after March 28, 2012.

Clause 52

No penalty – certain deemed payments

ITA
227(8.5)

New subsection 227(8.5) of the Act is introduced to provide two exemptions from the penalty for failing to withhold tax in subsection 227(8). Paragraph 227(8.5)(*a*) provides that no penalty will apply in respect of a dividend deemed to have been paid under subsection 214(16) unless the taxpayer would be liable for a penalty for failing to withhold on the payment of interest that is deemed to be a dividend. Similarly, paragraph 227(8.5)(*b*) provides that no penalty applies in respect of dividends deemed to have been paid due to a transfer pricing secondary adjustment under subsection 247(12).

Subsection 214(16) deems a dividend to have been paid by a corporation for the purposes of Part XIII to the extent that interest paid or payable by the corporation is not deductible because of subsection 18(4) or that an amount in respect of interest paid or payable by a partnership is included in computing the corporation's income under new paragraph 12(1)(*l.1*).

In the context of a transfer pricing secondary adjustment, subsection 247(12) deems a dividend to have been paid by a corporation for the purposes of Part XIII. For further information, see the commentary on subsections 214(16) and 247(12).

This subsection applies to taxation years that end after March 28, 2012.

Clause 53

Provision of information

ITA
241(4)(*d*)(vii)

Section 241 of the Act prohibits officials and other persons from using or communicating taxpayer information obtained under the Act unless they are specifically authorized to do so by one of the exceptions found in that section. Subparagraph 241(4)(*d*)(vii) authorizes the communication of taxpayer information to federal officials responsible for administering the *Pension Benefits Standards Act, 1985* and to provincial officials responsible for administering similar provincial legislation. The subparagraph is amended, consequential on the introduction of new section 147.5 pertaining to pooled registered pension plans (PRPPs), to authorize the communication of taxpayer information to federal officials and provincial officials responsible for administering the *Pooled Registered Pension Plans Act* or similar provincial legislation.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

ITA
241(10)

Subsection 241(10) of the Act includes the definition "official" for the purposes of section 241. The definition is amended, consequential on the introduction of new section 147.5 of the Act pertaining to pooled registered pension plans (PRPPs), to include a person employed in the service of a provincial authority engaged in administering a provincial law similar to the *Pooled Registered Pension Plans Act*. This amendment is relevant for the application of subparagraph 241(4)(*d*)(vii), which allows certain information to be communicated to a provincial official for the purpose of administering provincial PRPP legislation.

For further information regarding PRPPs, please see the commentary on section 147.5.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 54

Deemed dividends to non-residents

ITA
247(12)

New subsection 247(12) of the Act is introduced to clarify the treatment of “secondary adjustments” as dividends for purposes of Part XIII. Where the terms or conditions of a transaction or series of transactions do not reflect arm’s length terms and conditions, subsection 247(2) may adjust, for tax purposes, any amounts related to the transactions or series to reflect arm’s length and conditions. This is commonly referred to as a “primary adjustment”.

In general terms, subsection 247(12) provides that a corporation that is resident in Canada for the purposes of Part XIII and that is subject to a primary adjustment will be deemed to have paid a dividend to each non-arm’s length non-resident participant in the transaction or series of transactions equal to the benefit conferred on the non-resident. This is commonly referred to as a “secondary adjustment”.

For example, if a Canadian corporation buys goods from its non-resident parent corporation for $100 but parties dealing at arm’s length would have charged $80, the primary adjustment would reduce by $20 the cost of the goods to the Canadian taxpayer. A secondary adjustment of $20 reflects the benefit that was conferred on the non-resident parent (i.e., the amount by which the non-resident parent was overpaid for the goods).

Subsection 247(12) implements the secondary adjustment by deeming a dividend to have been paid by a particular corporation and received by a particular non-resident person immediately before the end of the particular corporation’s taxation year. Subsection 247(12) first treats the particular corporation (or a partnership of which the particular corporation is a member) as having undertaken no transactions or series of transactions other than those in which the particular non-resident person (or a partnership of which the particular non-resident person is a member) was a participant. In order for the subsection to apply, the particular non-resident person (or a partnership of which the particular non-resident person is a member) must deal at non-arm’s length with the particular corporation.

If, having regard to the foregoing, the particular corporation would have a transfer pricing capital adjustment or a transfer pricing income adjustment for the taxation year, then paragraph 247(12)(*a*) deems a dividend to have been paid by the particular corporation and received by the particular non-resident at the end of the year.

The amount of the deemed dividend is determined under paragraph 247(12)(*b*) and it is the amount that is the portion of the total of the particular corporation’s transfer pricing capital and income adjustments that exceed the transfer pricing capital and income setoff adjustments that could reasonably be considered to relate to the particular non-resident person (if the definition “transfer pricing capital adjustment” in subsection 247(1) were read without reference to the references therein to “1/2 of” and “3/4 of” and the only transactions or series of transactions undertaken by the particular corporation were those in which the particular non-resident was a participant). The “reasonably be considered” requirement accommodates series of transactions involving more than one non-resident person.

No deemed dividend will arise if the non-resident is a controlled foreign affiliate (as defined for the purposes of section 17) of the Canadian corporation since the benefit conferred on the non-resident is more akin to a capital contribution than a dividend.

This subsection applies to transactions (including transactions that are part of a series of transactions) that occur after March 28, 2012.

Repatriation

ITA
247(13)

New subsection 247(13) of the Act applies in circumstances where subsection 247(12) deems a dividend to have been paid by a Canadian corporation and received by a non-resident, and the non-resident repatriates an amount to the Canadian corporation. If the repatriation is made with the concurrence of the Minister of National Revenue, paragraph 247(13)(*a*) provides that the amount of the deemed dividend is reduced (in the subsection referred to as the "reduction") by the amount the Minister of National Revenue considers appropriate, having regard to all the circumstances.

This discretion provides the Minister of National Revenue with the ability to determine the amount of the reduction based on all the circumstances surrounding the secondary adjustment and the associated repatriation. This includes, but is not limited to, taking into consideration the currency in which the adjusted transaction and the repatriation occurs. For example, the Minister of National Revenue has the discretion to reduce a secondary adjustment in full where the repatriation is made in a foreign currency in respect of an adjusted transaction that occurred in the foreign currency even though that currency may have depreciated or appreciated in value relative to the Canadian dollar from the time of the transaction to the time of the repatriation.

As provided by paragraph 247(13)(*b*), interest under subsection 227(8.3) will, subject to subsection 247(14), be payable on amounts that were not withheld or deducted. This interest is computed from the day the Part XIII tax is required to be deducted or withheld (determined without reference to any reduction in the Part XIII tax resulting from repatriation under subsection 247(13)) until the day of the repatriation. For this purpose, the repatriation is treated as a remittance to the Receiver General in an amount equal to the reduction. Paragraph 247(13)(*b*) also provides that subsection 227(8.1) (which imposes joint and several liability on the particular non-resident person) will apply in respect of the interest that is payable as a result of the application of subsection 227(13).

This subsection applies to transactions (including transactions that are part of a series of transactions) that occur after March 28, 2012.

Repatriation – interest

ITA
247(14)

New subsection 247(14) of the Act provides that where the amount of a deemed dividend is reduced under paragraph 247(13)(*a*), the amount of interest payable on the tax that should have been withheld and remitted in respect of the deemed dividend may be reduced by the Minister of National Revenue, having regard to all the circumstances, including whether the country in which the relevant non-resident person is resident provides reciprocal treatment. For example, the amount of interest could be reduced if there is a reciprocal treatment by a country in which the non-resident person that received the deemed dividend is resident.

This subsection applies to transactions (including transactions that are part of a series of transactions) that occur after March 28, 2012.

Non-application of ss. 15, 56(2), 212.3(2) and 246

ITA
247(15)

Subsection 247(15) of the Act is introduced to ensure that benefits conferred on a non-resident in circumstances that result in a deemed dividend under subsection 247(12), or that would have resulted in a deemed dividend in the absence of the reduction under subsection 247(13), are subject to subsection 247(12) and not to any of section 15, subsections 56(2) and 212.3(2) and section 246. In circumstances where subsection 247(12) does not apply to deem a dividend (e.g., the taxpayer is a trust or natural person), these other provisions will remain applicable as appropriate.

This subsection applies to transactions (including transactions that are part of a series of transactions) that occur after March 28, 2012.

Clause 55

Definitions

ITA
248(1)

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

"registered disability savings plan"

The definition "registered disability savings plan" is amended to introduce the acronym "RDSP" for drafting convenience and to improve readability. A similar amendment is made in subsection 146.4(1).

This amendment comes into force on Royal Assent.

"registered education savings plan"

The definition "registered education savings plan" is amended to introduce the acronym "RESP" for drafting convenience and to improve readability. A similar amendment is made in subsection 146.1(1).

This amendment comes into force on Royal Assent.

Pooled registered pension plans

Several amendments to the subsection are made, consequential on the introduction of the tax rules applicable to pooled registered pension plans (PRPPs). For further information, please see the commentary on section 147.5.

These amendments will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

"pooled registered pension plan" or "PRPP"

A new definition "pooled registered pension plan" or "PRPP" is added to subsection 248(1) of the Act. It is introduced consequential on the rules in new section 147.5 relating to PRPPs. For all purposes of the Act, a PRPP is defined to have the same meaning assigned by the definition "PRPP" in new subsection 147.5(1). For further information, see the commentary on the definition "pooled registered pension plan" in subsection 147.5(1).

"registered pension plan"

A "registered pension plan" is defined to be a pension plan registered by the Minister of National Revenue for the purposes of the Act, if such registration has not been revoked.

The definition is amended to exclude PRPPs. Under new section 147.5, PRPPs are subject to separate rules and registration requirements. For further information, please see the commentary on section 147.5.

"retirement compensation arrangement"

A "retirement compensation arrangement" (RCA) is a plan or arrangement under which an employer makes payments to another person, called a custodian, so that benefits may be paid to an employee or any other person after the employee retires or otherwise severs his or her employment with the employer. In the absence of this definition, such arrangements would ordinarily be employee benefit plans. Various registered plans and other specified plans and arrangements are specifically excluded from the definition of an RCA by its paragraphs (*a*) to (*n*).

A new paragraph (*a.1*) is added to the definition to exclude a PRPP from being an RCA.

"salary deferral arrangement"

A "salary deferral arrangement" is generally defined as a plan or arrangement one of the main purposes of which is to permit a taxpayer to postpone tax in a taxation year in respect of salary or wages, the receipt of which has been deferred to a subsequent year. A number of plans or arrangements are expressly excluded from the definition, including registered pension plans, profit sharing plans and group sickness or accident insurance plans.

A new paragraph (*a.1*) is added to the definition to exclude a PRPP from being a salary deferral arrangement.

"specified unitholder"

A new definition "specified unitholder" is added to subsection 248(1) of the Act, consequential on the rules in new section 147.5 for PRPPs. Under new paragraph 147.5(3)(*e*), a PRPP becomes a revocable plan if at any time the PRPP holds property that the administrator knew or ought to have known is a "restricted investment" as defined in subsection 147.5(1). Whether an investment in any particular trust or partnership is a restricted investment will generally depend on whether a PRPP member holds a "significant interest" (under subsection 147.5(30)) in the trust or partnership. In this regard, the new definition "specified unitholder" is relevant.

A "specified unitholder", in relation to a partnership or trust the interests in which are described by units, is generally defined to be a taxpayer who would be a specified shareholder (as defined in subsection 248(1)) if the partnership or trust were a corporation and the unit held by the taxpayer in the trust or partnership was a share in that corporation with the same attributes as the unit (e.g., the conditions attached to the unit are the same conditions that are attached to the notional share for the purposes of determining whether the taxpayer is a specified unitholder).

"superannuation or pension benefit"

The definition "superannuation or pension benefit" generally includes any amount received out of or under a superannuation or pension fund or plan. The definition is amended, consequential on the introduction of new subsection 147.5 of the Act pertaining to PRPPs, to include an amount received from a PRPP, other than for the purposes of subparagraph 56(1)(*a*)(i). Under new paragraph 56(1)(*z.3*), amounts received by a taxpayer from a PRPP will be included in the taxpayer's income to the extent required under section 147.5.

For further information, please see the commentary on paragraph 56(1)(*z.3*) and section 147.5 relating to the taxation of amounts paid out of PRPPs.

Clause 56

Extended meaning of "spouse"

ITA
252(3)

Subsection 252(3) of the Act extends the meaning of the terms "spouse" and "former spouse" to include, for a number of purposes, a party to a void or voidable marriage. Subsection 252(3) is amended so that this rule also applies for the purposes of new section 147.5 pertaining to pooled registered pension plans.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 57

Investments in limited partnerships

ITA
253.1

Section 253.1 of the Act applies for the purposes of specified provisions of the Act and *Income Tax Regulations* where a trust or corporation holds an interest as a limited partner in a limited partnership. It provides that the trust or corporation will not, solely because of its acquisition and holding of the limited partnership interest, be considered to carry on any business or other activity of the partnership.

Section 253.1 is amended so that it also applies for the purposes of new subsection 147.5(8). That subsection provides that a trust governed by a PRPP is generally not subject to tax under Part I of the Act, except to the extent that it carries on a business. The amendment ensures that a PRPP trust will not, solely because of the acquisition and holding of an interest in a limited partnership, be considered to carry on a business carried on by the partnership.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Income Tax Regulations

Clause 58

Tax deductions – definitions

ITR
100(1)

"remuneration"

Part I of the *Income Tax Regulations* (the "Regulations") provides rules concerning deductions at source that must be withheld on specified amounts of "remuneration" paid to a taxpayer. Paragraph (*b*) of the definition "remuneration" in subsection 100(1) of the Regulations includes a payment to a taxpayer of a superannuation or pension benefit.

Paragraph (*b*) of the definition "remuneration" in subsection 100(1) of the Regulations is amended to provide an exemption from withholding tax for any amount distributed from a pooled registered pension plan (PRPP) that is not required to be included in the taxpayer's income under new paragraph 56(1)(*z.3*) of the Act or that is deemed to have been distributed to a deceased PRPP member by reason of new subsection 147.5(14) of the Act.

ITR
100(3)

Subsection 100(3) of the Regulations excludes certain amounts (including contributions to a registered pension plan) from the amount of remuneration paid to a taxpayer that is subject to withholding at source.

Paragraph 100(3)(*a*) is amended to also exclude employee contributions to a pooled registered pension plan (PRRP) from the amount of employee remuneration that is subject to withholding at source.

For further information regarding PRPPs, please see the commentary on new section 147.5 of the Act.

These amendments will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 59

Information returns – PRPPs

ITR
213

New section 213 of the Regulations is added, consequential on the introduction of new section 147.5 of the Act pertaining to pooled registered pension plans (PRPPs), to require the administrator of a PRPP to file an information return with the Minister of National Revenue in respect of the PRPP. The return for each calendar year must be filed in prescribed form on or before May 1 of the following year.

For further information regarding PRPPs, please see the commentary on new section 147.5.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 60

Prescribed annuity contracts

ITR
304(1)

Section 304 of the Regulations prescribes certain annuity contracts for exclusion from the rules in section 12.2 of the Act that require income from life insurance policies to be reported on an accrual basis. Paragraph 304(1)(*a*) provides an exclusion for annuity contracts purchased pursuant to a registered retirement savings plan (RRSP) or certain other registered plans.

Paragraph 304(1)(*a*) is amended, consequential on the introduction of new section 147.5 of the Act pertaining to pooled registered pension plans (PRPPs), to extend the exclusion from the accrual rules to annuity contracts issued as or under a PRPP. This change is implemented by referring to annuity contracts issued as or pursuant to an arrangement described in new paragraph 148(1)(*b.3*) of the Act. For further information, please see the commentary on paragraph 148(1)(*b.3*) of the Act.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 61

Capital cost allowance – interpretation

ITR
1104

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

Section 1104 is amended in three respects consequential on amendments made to Classes 43.1 and 43.2 in Schedule II to the Regulations as announced in Budget 2012. First, the definitions “plant residue” and “eligible waste fuel” are amended. Second, new subsection 1104(17) is added. Third, the preamble to subsection 1104(13) is amended to add a reference to new subsection 1104(17).

Classes 43.1 and 43.2 – energy conservation property

ITR
1104(13)

Subsection 1104(13) of the Regulations sets out various definitions that apply for the purposes of Class 43.1 (30% CCA rate) and Class 43.2 (50% CCA rate) in Schedule II to the Regulations.

Subsection 1104(13) is amended consequential on the expansion, as announced in Budget 2012, of Classes 43.1 and 43.2 to include certain properties.

The definition “eligible waste fuel” is amended to add a reference to plant residue. As well, the definition “plant residue,” is amended to specifically contemplate its use as an eligible waste fuel. The preamble to subsection 1104(13) is also amended to add a reference to new subsection 1104(17).

These amendments come into force on March 29, 2012.

ITR
1104(17)

New subsection 1104(17) of the Regulations is introduced to require environmental compliance in respect of certain properties before those properties can be included in Class 43.1 or 43.2 in Schedule II. Class 43.1 provides for an accelerated capital cost allowance (CCA) rate of 30% and Class 43.2 provides for a temporary accelerated CCA rate of 50% for certain Class 43.1 properties acquired before 2020.

Subsection 1104(17) prevents the inclusion of the capital cost of certain property in Class 43.1 or Class 43.2 in Schedule II if the property is not in compliance with environmental laws, by-laws and regulations at the time when the property becomes available for use. The new subsection applies to property that would otherwise be included in subparagraph (*c*)(i) of Class 43.1 or is described in any of subparagraphs (*d*)(viii), (ix), (xi) and (xiii) of Class 43.1 and paragraph (*a*) of Class 43.2. Property is not in compliance if at the time the property becomes available for use by the taxpayer, the taxpayer has not satisfied the requirements of all environmental laws, by-laws and regulations of Canada, a province or a municipality in Canada, or of a municipal or public body performing a function of government in Canada, applicable in respect of the property.

If a property is excluded from Class 43.1 or Class 43.2 because of new subsection 1104(17), the property may be included in the CCA class that would otherwise apply to that property.

This amendment comes into force on March 29, 2012.

Clauses 62 to 64

Scientific research and experimental development

ITR
Part XXIX

Part XXIX of the Regulations provides rules with respect to scientific research and experimental development.

Scientific research and experimental development

ITR
2900

Section 37 of the Act allows the deduction of certain expenditures incurred by a taxpayer on scientific research and experimental development (SR&ED). Section 127 of the Act provides for, among other things, investment tax credits (ITCs) for certain SR&ED expenditures described in section 37 of the Act. Section 2900 of the Regulations provides the meanings of terms and expressions used in sections 37 and 127 of the Act.

ITR
2900(4)

Subsections 2900(4) to (10) of the Regulations determine the prescribed proxy amount for the purposes of paragraph (*b*) of the definition “qualified expenditure” in subsection 127(9) of the Act. The prescribed proxy amount provides a simplified method for calculating overhead expenditures for the purpose of determining SR&ED ITCs. The prescribed proxy amount is a substitute for an item-by-item accounting and apportioning of certain expenditures that could otherwise be considered to be directly attributable to SR&ED carried on in Canada. The prescribed proxy amount is relevant only for the purposes of calculating SR&ED ITCs. It does not form part of the SR&ED expenditure pool under subsection 37(1) of the Act and neither do any of the expenditures for which the prescribed proxy amount is a substitute.

Under subsection 2900(4) of the Regulations, the prescribed proxy amount is currently 65% of the total of the eligible portion of salaries of employees directly engaged in SR&ED in Canada. Budget 2012 announced the reduction of the applicable percentage to 60% for 2013 and to 55% after 2013.

Subsection 2900(4) is amended to replace the reference to the percentage rate in the calculation of the prescribed proxy amount with 55%. This amendment applies to taxation years that end after 2012 except that for taxation years that include days in 2012 or 2013 the applicable percentage will be prorated using 65% and 60%, respectively, based on the number of days in the taxation year that are in each of those calendar years.

Prescribed expenditures

ITR
2902

Section 2902 of the Regulations sets out the expenditures that are prescribed expenditures for the purposes of the definition "qualified expenditure" in subsection 127(9) of the Act. Prescribed expenditures do not qualify for investment tax credits (ITCs).

Section 2902 of the Regulations is amended in two respects consequential on changes to the scientific research and experimental development (SR&ED) and ITC provisions in the Act announced in Budget 2012.

ITR
2902(*b*)

Paragraph 2902(*b*) of the Regulations provides that certain expenditures of a capital nature are prescribed expenditures for the purposes of the definition "qualified expenditure" in subsection 127(9).

Subparagraph 2902(*b*)(ii) of the Regulations is amended to add a reference to the new definition "qualified resource property" in subsection 127(9) of the Act. This amendment ensures that the cost of the acquisition of qualified resource property is not a qualified expenditure for SR&ED ITC purposes.

Paragraph 2902(*b*) of the Regulations is also further amended consequential on the repeal of paragraph 37(1)(*b*) of the Act, amendments to paragraph 37(8)(*d*) of the Act and the amendment of the definition "first term shared-use-equipment" in subsection 127(9) of the Act.

The amendment to subparagraph 2902(*b*)(ii) applies in respect of expenditures incurred after March 28, 2012, while the other amendments to paragraph 2902(*b*) apply in respect of expenditures incurred after 2013.

ITR
2902(*e*)

Paragraph 2902(*e*) of the Regulations is amended to remove a reference to "of a current or a capital nature". This change is consequential on the repeal of paragraph 37(1)(*b*) of the Act and amendments to the definition "qualified expenditure" in subsection 127(9) of the Act.

This amendment applies in respect of expenditures incurred after 2013.

Special-purpose buildings

ITR
2903

Expenditures in respect of the capital cost of a building are generally not deductible under section 37 of the Act except in the case of a prescribed special-purpose building. Section 2903 of the Regulations describes a prescribed special-purpose building for the purposes of paragraph 37(8)(*d*) of the Act.

Section 2903 of the Regulations is repealed consequential on the repeal of paragraph 37(1)(*b*) of the Act and amendments to paragraph 37(8)(*d*) of the Act.

This amendment applies after 2013.

Clause 65

Prescribed rate of interest

ITR
4301

Section 4301 of the Regulations prescribes rates of interest for various provisions of the Act. Section 4301 is amended to add new paragraph 4301(*b.1*), which applies for the purposes of new subsection 17.1(1) of the Act. Paragraph 4301(*b.1*) is a modified version of paragraph 4301(*a*) in that it includes the 4 percentage point increase over the Government of Canada treasury bills rate, but it does not use the "rounding-up" convention of paragraph (*a*). Instead, similar to section 4302 of the Regulations, it simply rounds the applicable interest rate to two decimal points.

This amendment comes into force on March 29, 2012.

Clause 66

Investment tax credit – qualified property

ITR
4600

Part XLVI of the Regulations provides rules that apply for the purposes of various definitions in subsection 127(9) of the Act. The definitions in subsection 127(9) of the Act are relevant for the purposes of the investment tax credit (ITC) regime.

A 10% ITC is available for certain assets used in the Atlantic provinces, the Gaspé Peninsula and their associated offshore regions (commonly referred to as the Atlantic ITC). Atlantic ITCs can be claimed in respect of the cost of qualified property as defined in subsection 127(9) of the Act. As well, Atlantic ITCs can be claimed in respect of qualified resource property as defined in subsection 127(9) of the Act – this new definition applies in respect of expenditures incurred and property acquired after March 28, 2012.

Section 4600 of the Regulations is amended in two respects. First, subsections 4600(1) and (2) of the Regulations are amended to ensure that the buildings and machinery and equipment described in those subsections are prescribed buildings and prescribed machinery and equipment for the purposes of the definition "qualified resource property" in subsection 127(9) of the Act. Second, new subsection 4600(3) of the Regulations is added to describe prescribed energy generation and conservation property for the purposes of the definition "qualified property" in subsection 127(9) of the Act.

ITR
4600(1)

Subsection 4600(1) of the Regulations sets out what constitutes a prescribed building for the purposes of the definition "qualified property" in subsection 127(9) of the Act. An Atlantic ITC may be earned in respect of the cost of a qualified property. An Atlantic ITC may be deduced, under subsection 127(5) of the Act, against tax otherwise payable by a taxpayer.

The preamble to subsection 4600(1) is amended to add a reference to the new definition "qualified resource property", consequential on the introduction of that definition in subsection 127(9) of the Act. This amendment ensures that the cost of a building described in the subsection is a prescribed building for the purposes of the definition "qualified resource property" in subsection 127(9) of the Act and is therefore eligible for an Atlantic ITC.

This amendment comes into force on March 29, 2012.

ITR
4600(2)

Subsection 4600(2) of the Regulations prescribes machinery and equipment for the purposes of the definition "qualified property" in subsection 127(9) of the Act. An Atlantic ITC may be earned in respect of the cost of a qualified property. A deduction may be claimed, under subsection 127(5) of the Act, in respect of an ITC against tax otherwise payable by a taxpayer.

The preamble to subsection 4600(2) is amended to add a reference to the new definition "qualified resource property", consequential on the introduction of that definition in subsection 127(9) of the Act. This amendment ensures that the cost of machinery and equipment described in the subsection is prescribed machinery and equipment for the purposes of the definition "qualified resource property" in subsection 127(9) of the Act and is therefore eligible for an Atlantic ITC.

This amendment comes into force on March 29, 2012.

ITR
4600(3)

New subsection 4600(3) of the Regulations prescribes certain energy generation and conservation property for the purposes of the definition "qualified property" in subsection 127(9) of the Act. Prescribed energy generation and conservation property is depreciable property included in any of subparagraph (a.1)(i) of Class 17 and Classes 43.1, 43.2 and 48 of Schedule II to the Regulations. This amendment ensures that the cost of energy generation and conservation property described in the subsection is prescribed energy generation and conservation property for the purposes of the definition "qualified property" in subsection 127(9) of the Act and is therefore eligible for an Atlantic ITC.

Subsection 4600(3) comes into force on March 29, 2012.

Clause 67

Pension investment corporations and trusts

ITR
4802(1)

Paragraph 149(1)(*o.2*) of the Act exempts from tax certain types of corporations involved with pension fund administration and investments if all the shares and rights to acquire shares of the corporation are owned by one or more registered pension plans or specified persons. Specified persons include persons prescribed persons under subsection 4802(1) of the Regulations.

New paragraph 4802(1)(*c.3*) adds pooled registered pension plans to be the list of prescribed persons.

ITR
4802(1.1)

Subsection 4802(1.1) of the Regulations sets out the conditions under which a trust is a "master trust" for the purposes of paragraph 149(1)(*o.4*) of the Act. Among other things, a master trust holds investments exclusively for beneficiaries that are registered pension plans or deferred profit sharing plans. The taxable income of a paragraph 149(1)(*o.4*) master trust is exempt from Part I tax pursuant to subsection 149(1) of the Act.

Subsection 4802(1.1) is amended to add pooled registered pension plans to the list of permitted beneficiaries of master trusts.

These amendments will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 68

Permanent establishment

ITR
8201

Section 8201 of the Regulations defines the meaning of "permanent establishment" for various purposes of the Act. This section is amended in two ways.

First, section 8201 is amended to add a reference to subsection 100(1.3) of the Act, which concerns the exception from the special capital gain rule in subsection 100(1) of the Act. In general terms, subsection 100(1) may apply to a disposition of an interest in a partnership to a person exempt from tax under section 149 of the Act or a non-resident person where the partnership holds properties the disposition of which can result in the realization of income, such as depreciable property and inventory of a business.

Second, section 8201 is amended to delete a cross reference to former subsection 34.2(6) of the Act, which concerns now-repealed transitional relief rules in respect of changes to the definition "fiscal period".

These amendments apply to the 2012 and subsequent taxation years.

Clause 69

Registered pension plans

ITR
8502(*b*)

Paragraph 8502(*b*) of the Regulations lists contributions that are permitted to be made to a registered pension plan (RPP). The list includes transfers from other registered plans in accordance with any of subsections 146(16) (from a registered retirement savings plan), 146.3(14.1) (from a registered retirement income fund), 147(19) (from a deferred profit sharing plan) and 147.3(1) to (8) of the Act (from an RPP).

Paragraph 8502(*b*) is amended to expand the list of permissible contributions to include transfers from a pooled registered pension plan (PRPP) made in accordance with new subsection 147.5(21) of the Act. Subsection 147.5(21) permits the direct transfer of an amount from a PRPP account, on behalf of an individual who is a PRPP member or surviving spouse or common-law partner, to an RPP for the benefit of the individual.

For further information regarding PRPPs, please see the commentary on section 147.5.

This amendment will come into force on the day of the coming into force of the *Pooled Registered Pension Plans Act*.

Clause 70

Schedule II – capital cost allowance

ITR
Class 43.1 and 43.2

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

Class 43.1 (and indirectly Class 43.2) is amended in two respects to implement the Budget 2012 proposals that expand Class 43.2 with respect to waste-fuelled thermal energy equipment and equipment of a district energy system that uses thermal energy provided primarily by eligible waste-fuelled thermal energy equipment. These amendments complement the Budget 2012 proposal to include equipment that uses the residue of plants – generally produced by the agricultural sector – to generate electricity and heat.

ITR
Class 43.1(*d*)(ix)

Subparagraph (*d*)(ix) of Class 43.1 applies to equipment that generates heat primarily from the consumption of an eligible waste fuel only if two conditions are met. The first condition is that the heat generated by the equipment must be used in an industrial process or a greenhouse. Budget 2012 announced the removal of this condition. The second condition is that no fuel other than a fossil fuel or an eligible waste fuel be used to generate the heat.

Subparagraph (*d*)(ix) of Class 43.1 is amended in three respects. First, the term "if the heat energy is used directly in an industrial process, or in a greenhouse," is deleted. This amendment implements the Budget 2012 proposal to remove the first above-mentioned condition.

Second, the term "sole" is added to ensure that equipment described in the subparagraph (*d*)(ix) is used only for the purpose of generating heat and the term "primarily" is moved to clarify that it relates to the consumption of eligible waste fuel.

Consequential on the second amendment, subparagraph (*d*)(ix) is amended to replace the reference to "electrical generating equipment" in the exclusion list with a reference to "equipment used for the purpose of producing heat energy to operate electrical generating equipment."

These amendments come into force on March 29, 2012.

ITR
Class 43.1 (*d*)(xv)

Budget 2012 proposed to expand Class 43.2 to include equipment that is part of a district energy system and that distributes thermal energy primarily generated by waste-fuelled thermal energy equipment.

Property described in paragraph (*d*) of Class 43.1 is included in Class 43.2. District energy equipment that is part of a district energy system is currently included in subparagraph (*d*)(xv) of Class 43.1 only if the system distributes thermal energy primarily generated by one or more of an eligible cogeneration system, a ground source heat pump, active solar heating equipment and heat recovery equipment.

Clause (*d*)(xv)(B) of Class 43.1 is amended to add a reference to property described in subparagraph (*d*)(ix) of Class 43.1. This amendment adds waste-fuelled thermal energy equipment to the list of eligible sources of energy generation for the purposes of subparagraph (*d*)(xv).

This amendment comes into force on March 29, 2012.

Canada Disability Savings Regulations

Clause 71

Transfer of information

CDSR
4

When a registered disability savings plan (RDSP) is transferred to a new issuer, a great deal of information about the original plan has to be transferred by the original issuer to the new issuer.

To reduce the administrative burden on issuers, Budget 2012 proposed that Human Resources and Skills Development Canada, rather than the original issuer, be responsible for providing this information to the issuer of the new plan. Paragraph 146.4(8)(*c*) of the *Income Tax Act*, which sets out the rules governing transfers from one RDSP of a beneficiary to another, is amended to require that the original issuer provide to the issuer of the new plan only the information that the specified Minister (i.e., the Minister of Human Resources and Skills Development) has not provided to the issuer of the new plan at the time of the transfer.

Section 4 of the *Canada Disability Savings Regulations* (the "CDSR") sets out the terms and conditions of the issuer agreement and paragraph 4(*g*) establishes the requirement to transfer information to a new issuer. Paragraph 4(*g*) is amended to refer to paragraph 146.4(8)(*c*) of the *Income Tax Act*. The purpose is to ensure that the CDSR and the *Income Tax Act* contain parallel requirements governing the transfer of information.

This amendment comes into force on Royal Assent.

Clause 72

Repayments

CDSR
5

Currently, all grants and bonds paid into a registered disability savings plan (RDSP) in the preceding 10 years must be repaid to the Government if any amount is withdrawn from an RDSP and upon the occurrence of certain other events (the "10-year repayment rule"). To provide greater access to RDSP savings for small withdrawals, while still supporting the long-term savings objective of RDSPs, Budget 2012 announced the introduction of a proportional repayment rule requiring that $3 of grants and bonds be repaid for every $1 withdrawn from an RDSP (the "proportional repayment rule"). The proportional repayment rule replaces the 10-year repayment rule only in respect of withdrawals (referred to as disability assistance payments).

Accordingly, paragraph 5(1)(*c*) of the CDSR, which applies when a withdrawal occurs, has been removed and the paragraphs renumbered.

Budget 2012 also proposed to extend, in certain circumstances, the period of time during which an RDSP may remain open when a beneficiary becomes ineligible for the disability tax credit (DTC), but is likely to become eligible for the DTC again in the foreseeable future ("the DTC-ineligibility measure"). To take advantage of this measure, the plan holder must make an election to keep the plan open. The conditions that must be met in order to make this election are set out in more detail in new subsection 146.4(4.1) of the *Income Tax Act*.

Subsection 5(1) of the CDSR currently requires that all grants and bonds paid into an RDSP in the 10 years preceding the loss of eligibility for the DTC be repaid to the Government.

New paragraph 5(1)(*c*) gives effect to the DTC-ineligibility measure. If an RDSP beneficiary becomes DTC-ineligible, and if an election is made under subsection 146.4(4.1) of the *Income Tax Act* to keep the plan open for up to five years, no grants and bonds must be repaid during that time period, unless an event that triggers the proportional repayment rule or the 10-year repayment rule occurs.

To improve readability and to ensure stylistic consistency with new sections 5.1 and 5.2 and subsections 5.3(1) and 5.4(1) of the CDSR, the paragraphs in subsection 5.1(2) of the CDSR have been re-ordered.

The amendments to subsections 5(1) and (2) come into force on January 1, 2014.

Clause 73

Repayments

The remaining regulatory amendments set out the repayment obligation in specific circumstances (e.g., if a withdrawal is made from a registered disability savings plan (RDSP) or if certain events occur while there is an election under the DTC-ineligibility measure, discussed under the commentary for subsections 5(1) and (2) of the CDSR). The amendments are addressed separately.

CDSR
5.1

New section 5.1 of the CDSR applies when an RDSP beneficiary has become DTC-ineligible, an election to take advantage of the DTC-ineligibility measure in subsection 146.4(4.1) of the *Income Tax Act* has been made and is still in effect, and one of the following "trigger" events occurs:

- the RDSP is terminated;
- the RDSP becomes non-compliant and thus is deregistered as a result of the application of paragraph 146.4(10)(*a*) of the *Income Tax Act*; or
- the beneficiary dies.

Section 5.1 sets out the amount of grants and bonds that the RDSP issuer must repay to the Minister in these circumstances. That amount is the lesser of:

- the fair market value of the property in the RDSP immediately before one of the three "trigger" events (listed above) occurred, and
- the "assistance holdback amount" of the RDSP immediately before the RDSP beneficiary became DTC-ineligible plus the amount of any grant or bond paid into the RDSP in the period beginning on the day on which the beneficiary became DTC-ineligible and ending on the day the event occurred, less the amount of any grant or bond repaid since the day on which the beneficiary became DTC-ineligible.

The "assistance holdback amount" is defined in the interpretation section of the CDSR. It is the total amount of bonds and grants paid into an RDSP within the 10-year period before a particular event, less any grants or bonds repaid to the Minister.

Funds in an RDSP may be invested in financial instruments that may fluctuate in value. Section 5.1 allows for this possibility. If the fair market value of the property in the plan is less than the "assistance holdback amount" at the time that one of the "trigger" events occurs, only the fair market value of the property in the plan must be repaid.

Section 5.1 comes into force on January 1, 2014.

CDSR
5.2

Some people with episodic illnesses, and certain other ailments, may become DTC-ineligible on a temporary basis. Budget 2012 proposed to allow a plan holder to elect to keep the plan open for up to five years when the beneficiary has become DTC-ineligible ("the DTC-ineligibility measure"). New subsections 146.4(4.1) and 146.4(4.2) of the *Income Tax Act* give effect to this measure.

Under new paragraph 146.4(4.2)(*b*) of the *Income Tax Act*, if the RDSP beneficiary does not re-qualify for the DTC within five years of becoming DTC-ineligible, the election ceases to be valid at the end of the fifth taxation year for which the beneficiary is DTC-ineligible. The plan will then have to be wound up by the end of the year following that taxation year.

New section 5.2 of the CDSR sets out the amount of grants and bonds that the issuer must repay if the plan is wound up. That amount is the lesser of:

- the fair market value of the property in the RDSP immediately before the election to take advantage of the "DTC-ineligibility measure" ceases to be valid, and
- the "assistance holdback amount" of the RDSP immediately before the RDSP beneficiary became DTC-ineligible, plus the amount of any grant or bond paid into the RDSP in the period beginning on the day on which the beneficiary became DTC-ineligible and ending on the day the election ceases to be

valid, less the amount of any grant or bond repaid since the day on which the beneficiary became DTC-ineligible.

In section 5.2, “fair market value” is determined at a different point in time than in the preceding section. In subsection 5.1, “fair market value” is determined as of the point of time, after an election is made, when a “trigger” event occurs (i.e., the plan is terminated, or the plan is deregistered, or the beneficiary dies). In section 5.2, “fair market value” is the value immediately before an election made under subsection 146.4(4.1) of the *Income Tax Act* ceases to be valid (because the beneficiary did not qualify with the DTC within five years).

Section 5.2 comes into force on January 1, 2014.

CDSR
5.3

New section 5.3 of the CDSR sets out the repayment obligations of the issuer when an RDSP beneficiary is DTC-eligible and a disability assistance payment is made from the RDSP.

Section 5.3 also implements the proportional repayment rule announced in Budget 2012. This rule requires that $3 of grants and bonds are to be repaid to the Government for each $1 withdrawn from an RDSP. This rule replaces the 10-year repayment rule (described above), but only in respect of disability assistance payments.

Under subsection 5.3(1), if there is a disability assistance payment from an RDSP, the issuer must repay, to the Government, the least of the following three amounts:

- $3 for every $1 withdrawn from the RDSP;
- the assistance holdback amount of the RDSP immediately before the making of the disability assistance payment, and
- the fair market value of the property in the RDSP immediately before the making of the disability assistance payment.

For example, consider a plan with $5,000 in contributions, $10,000 in grants and bonds that have been paid into the plan in the last 10 years, and a fair market value of $17,000. If $3,000 is withdrawn from the plan, the issuer will have to repay to the Minister $9,000 in grants and bonds, as the amount calculated under the proportional repayment rule ($9,000) is less than the “assistance holdback amount” ($10,000) and the fair market value of the property at the time of the withdrawal ($17,000).

Subsection 5.3(2) sets out the order in which the repayment of grant and bonds is to occur. The issuer first repays the oldest government grants and bonds deposited into the RDSP during the 10-year period that is prior to the disability assistance payment.

Section 5.3 comes into force on January 1, 2014.

CDSR
5.4

Subsection 5.4 of the CDSR sets out the repayment requirement where:

- an RDSP beneficiary has ceased to be DTC-eligible,
- an election under subsection 146.4(4.1) of the *Income Tax Act* has been made to keep the plan open for up to five years, and
- a disability assistance payment is made.

Under subsection 5.4(1), the amount of the repayment will be the least of the following amounts:

- $3 for every $1 withdrawn from the RDSP,

- the fair market value of the property in the RDSP immediately before the disability assistance payment is made, and
- the "assistance holdback amount" of the RDSP immediately before the RDSP beneficiary became DTC-ineligible, plus the amount of any grant or bond paid into the RDSP in the period beginning on the day on which the beneficiary became DTC-ineligible and ending on the day the disability assistance payment is made, less the amount of any grant or bond repaid since the day on which the beneficiary became DTC-ineligible.

Subsection 5.4(2) sets out the order in which the repayment of grant and bonds occurs. The issuer must first repay the oldest government grants and bonds deposited into the RDSP during the period starting 10 years before the loss of DTC-eligibility and ending on the day on which the disability assistance payment is made.

Subsection 5.4(3) provides an exemption from the repayment requirement under subsection 5.4(1) where an election under subsection 146.4(4.1) of the *Income Tax Act* has been made and the beneficiary has attained 60 years of age.

Budget 2012 proposed to require that, once the beneficiary attains 60 years of age, the total of disability assistance payments made from an RDSP in a calendar year must be at least equal to the amount determined under paragraph 146.4(4)(*l*) of the *Income Tax Act* (the "LDAP formula") for the year.

The effect of subsection 5.4(3) is that, if an election under subsection 146.4(4.1) of the *Income Tax Act* has been made, in the year the beneficiary reaches age 60 and thereafter, if the total of disability assistance payments in a year is less than or equal to the amount determined under the LDAP formula for the year, the disability assistance payments made in that year will not be subject to the proportional repayment rule. This ensures that RDSP beneficiaries who are required to withdraw the amount determined by the LDAP formula for a year do not have to repay grants or bonds in that year.

However, the exemption provided by subsection 5.4(3) does not apply if the total of disability assistance payments in a year exceeds the amount determined under the LDAP formula for the year, in which case the issuer will have to repay the amount determined under subsection 5.4(1) in its entirety.

Section 5.4 comes into force on January 1, 2014.

Part 2

Measures in Respect of Sales Tax

Where applicable, the references in these explanatory notes to the provisions of the *Excise Tax Act* (the Act) and the *Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations* should be read as provisions adapted, enabled or modified by the draft *Regulations Amending Various GST/HST Regulations* released on January 28, 2011.

Excise Tax Act

Clause 74

Definitions

ETA
123(1)

Subsection 123(1) of the Act defines terms used in Part IX of the Act and in the Schedules to the Act relating to the goods and services tax/harmonized sales tax (GST/HST).

Subsection 123(1) is amended to amend the definition “fiscal year” and to add new definitions “participating employer”, “pension entity” and “pension plan”.

“fiscal year”

The definition “fiscal year” in subsection 123(1) of the Act provides that a person’s fiscal year is its taxation year (as defined in that subsection), except where the person has made an election under section 244 of the Act that is in effect, in which case the person’s fiscal year is the period that the person elected to be its fiscal year.

The definition “fiscal year” is amended to provide that, if new section 244.1 of the Act applies to a person, the person’s fiscal year is instead the period determined under that section.

The amendments to the definition “fiscal year” are deemed to have come into force on July 1, 2009.

“participating employer”, “pension entity” and “pension plan”

Subsection 123(1) is amended to add the definitions “participating employer”, “pension entity” and “pension plan”. These definitions are moved from section 172.1 of the Act to avoid repetition and now apply for the purposes of section 121 and Part IX of the Act and Schedules V to X to the Act.

The definitions “participating employer”, “pension entity” and “pension plan” are deemed to have come into force on September 23, 2009.

Clause 75

Pension Plans

ETA
172.1(1)

Subsection 172.1(1) of the Act defines terms for the purposes of section 172.1.

Subsection 172.1(1) is amended to repeal the definitions “participating employer”, “pension entity” and “pension plan”. The amendments are consequential to the addition of these definitions to subsection 123(1) of the Act.

The amendments to subsection 172.1(1) are deemed to have come into force on September 23, 2009.

Clause 76

Tax in Participating Province

ETA
218.1

Section 218.1 of the Act imposes tax in respect of the provincial component of the HST on “imported taxable supplies” (as defined in section 217 of the Act) of property and services made outside Canada where the property or service is acquired for consumption, use or supply otherwise than exclusively in the course of a commercial activity. It also includes a self-assessment provision in respect of the provincial component of the HST that is applicable to qualifying taxpayers (as described in subsection 217.1(1) of the Act) resident in a participating province.

Section 218.1 is amended with respect to the self-assessment rules for certain taxpayers.

ETA
218.1(1)

Subsection 218.1(1) imposes tax in respect of the provincial component of the HST on “imported taxable supplies” of property and services made outside Canada where the property or service is acquired for consumption, use or supply in an HST province otherwise than exclusively in the course of a commercial activity.

Paragraph 218.1(1)(*a*) provides that a resident of a participating province who is the recipient of an imported taxable supply of intangible personal property or a service is liable for the provincial component of the HST where the property or service is acquired by the resident for consumption, use or supply to an extent prescribed by regulations (currently, an extent of at least 10%) in the participating provinces. The amount of tax payable in these circumstances is calculated with regard to the extent to which the intangible property or service will be consumed, used or supplied in the participating province in which the recipient is resident.

Paragraph 218.1(1)(*a*) is amended to provide that where a resident of a participating province who is the recipient of an imported taxable supply of intangible personal property or a service acquires the property or service for a purpose prescribed by regulations in respect of the supply, the recipient is liable for the provincial component of the HST irrespective of the extent to which the property was acquired for consumption, use or supply in participating provinces. Paragraph 218.1(1)(*a*) is also amended to provide that the tax is calculated using the prescribed percentage in respect of the supply or, in the absence of such a prescribed percentage in respect of the supply, the extent to which the property or service is acquired for consumption, use or supply in the participating province in which the recipient is resident.

Paragraph 218.1(1)(*b*) provides that the provincial component of the HST is also imposed upon every registrant who is the recipient of a taxable supply described in any of paragraphs (*b*.1), (*b*.2), (*b*.3), (*c*.1), (*d*) or (*e*) of the definition “imported taxable supply” in section 217. Where the imported taxable supply is a supply of intangible personal property or a service, the tax is calculated with regard to the extent to which the property or service is acquired for consumption, use or supply in the participating province in which the supply is made.

Paragraph 218.1(1)(*b*) is amended to provide that, in the case of an imported taxable supply of intangible personal property or a service, the tax is calculated using the percentage prescribed by regulations in respect of the supply or, in the absence of such a prescribed percentage in respect of the supply, the extent to which the property or service is acquired for consumption, use or supply in the participating province in which the supply is made.

Proposed regulations under paragraphs 218.1(1)(*a*) and (*b*) would generally provide for self-assessment by certain investment plans (as described in subsection 149(5) of the Act) and segregated funds of insurers (as those terms are defined in subsection 123(1) of the Act). More specifically, the amendments would provide for self-assessment under these paragraphs in the following cases:

- In the case of provincial series (generally, series created exclusively for investors resident in a single province) of investment plans and segregated funds which are selected listed financial institutions (as described in subsection 225.2(1) of the Act) - where the provincial series is created for investors resident in a participating province, the investment plan or segregated fund would be required to self-assess that province’s provincial component of the HST under these paragraphs in respect of property and services that relate to the provincial series.
- In the case of provincial investment plans (generally, investment plans or segregated funds created exclusively for investors resident in a single province) - where the provincial investment plan is created for investors resident in a participating province, the provincial investment plan would be required to self-assess that province’s provincial component of the HST under these paragraphs.

The amendments to subsection 218.1(1) apply in respect of any supply made on or after July 1, 2010.

ETA
218.1(1.1)

Subsection 218.1(1.1) of the Act ensures that the same rules apply to determine if property is delivered in a particular province for the purposes of Division IV as apply for the purposes of Division II.

A technical consequential amendment is made to subsection 218.1(1.1) to change the erroneous reference to paragraph 218.1(1)(*c*), which is now repealed, to subparagraph 218.1(1)(*b*)(ii).

The amendment to subsection 218.1(1.1) is deemed to have come into force on July 1, 2010.

ETA
218.1(1.2)

Subsection 218.1(1.2) of the Act is a self-assessment provision that applies to qualifying taxpayers (as described in subsection 217.1(1)) that are resident in a participating province. The tax imposed under this provision must be determined for each participating province if the qualifying taxpayer is resident in any participating province.

Paragraph 218.1(1.2)(*a*) applies where an election under subsection 217.2(1) of the Act is in effect for a specified year (as defined in section 217) and requires a qualifying taxpayer that is resident in a participating province to analyze each amount in respect of an internal charge (as described in subsection 217.1(4) of the Act) or an external charge (as defined in section 217) for the specified year that is greater than zero and to self-assess the provincial component of the HST on a certain extent of each of these amounts.

Paragraph 218.1(1.2)(*a*) is amended to provide that the provincial component of the HST in respect of an internal charge or an external charge is to be determined using the extent provided for in existing paragraph 218.1(1.2)(*a*) only in the absence of a percentage prescribed by regulations in respect of the internal charge or external charge, as the case may be. Where a prescribed percentage exists in respect of an internal charge or an external charge, the provincial component of the HST in respect of the internal charge or external charge is to be determined using the prescribed percentage.

Paragraph 218.1(1.2)(*b*) applies where no election under subsection 217.2(1) is in effect for a specified year and requires a qualifying taxpayer that is resident in a participating province to analyze each amount of qualifying consideration (as defined in section 217) for the specified year that is greater than zero and to self-assess the provincial component of the HST on a certain extent of each of these amounts.

Paragraph 218.1(1.2)(*b*) is amended to provide that the provincial component of the HST in respect of an amount of qualifying consideration is to be determined using the extent provided for in existing paragraph 218.1(1.2)(*b*) only in the absence of a percentage prescribed by regulations in respect of the qualifying consideration. Where a prescribed percentage exists in respect of qualifying consideration, the provincial component of the HST in respect of the qualifying consideration is to be determined using the prescribed percentage.

Proposed regulations under paragraphs 218.1(1.2)(*a*) and (*b*) would generally provide for self-assessment by certain investment plans and segregated funds of insurers. More specifically, the amendments would provide for self-assessments under these paragraphs in the following cases:

- In the case of provincial series (generally, series created exclusively for investors resident in a single province) of investment plans and segregated funds which are selected listed financial institutions - where the provincial series is created for investors resident in a participating province, the investment plan or segregated fund would be required to self-assess that province’s provincial component of the HST under these paragraphs in respect of internal charges, external charges and amounts of qualifying consideration that relate to the provincial series.
- In the case of provincial investment plans (generally, investment plans or segregated funds created exclusively for investors resident in a single province) - where the provincial investment plan is created for investors resident in a participating province, the provincial investment plan would be required to self-assess that province’s provincial component of the HST under these paragraphs.

The amendments to subsection 218.1(1.2) apply in respect of any specified year of a person that ends on or after July 1, 2010.

Clause 77

Pension Entities

ETA
220.05(3.1)

Subsection 220.05(3.1) of the Act provides that no tax under subsection 220.05(1) becomes payable on the bringing into a participating province of tangible personal property by a pension entity of a pension plan where the tangible personal property had been supplied to the pension entity by a participating employer of the same pension plan and where the amount of the provincial component of the HST determined under paragraph 172.1(5)(*c*) of the Act (in respect of a supply made by the participating employer of the same tangible personal property) or under paragraph 172.1(6)(*c*) (in respect of a supply made by the participating employer of an employer resource (as referred to in subsection 172.1(6)) consumed or used to make the supply of the same tangible personal property) is greater than zero.

Consequential amendments are made to subsection 225.05(3.1) to reflect that the definitions “participating employer”, “pension entity” and “pension plan” are now contained in subsection 123(1) of the Act and apply for the purposes of Part IX of the Act.

The amendments to subsection 220.05(3.1) are deemed to have come into force on September 23, 2009.

Clause 78

Tax in Participating Province

ETA
220.08

Section 220.08 of the Act provides for self-assessment in certain cases by persons who are residents of a participating province and who are the recipients of certain taxable supplies of intangible personal property or services acquired for consumption, use or supply in a participating province.

ETA
220.08(1)

Subsection 220.08(1) provides for self-assessment of the provincial component of the HST by a resident of a participating province in respect of a taxable supply of intangible personal property or a service that is acquired for consumption, use or supply in any of the participating provinces other than the province where the supply is made.

Subsection 220.08(1) is amended to provide for self-assessment of the provincial component of the HST by a resident of a participating province in respect of a taxable supply of intangible personal property or a service that is acquired

- for a purpose prescribed by regulations in respect of the supply; or
- in the absence of a prescribed purpose, for consumption, use or supply in any of the participating provinces other than the province where the supply is made.

The prescribed purposes as provided in the proposed regulations under subsection 220.08(1) would include self-assessment by certain investment plans (as described in subsection 149(5) of the Act) and segregated funds of insurers (as those terms are defined in subsection 123(1) of the Act). More specifically, the amendments would provide for self-assessments under these paragraphs in the following cases:

- In the case of provincial series (generally, series created exclusively for investors resident in a single province) of investment plans and segregated funds which are selected listed financial institutions (as described in subsection 225.2(1) of the Act) - where the provincial series is created for investors resident in a participating province, the investment plan or segregated fund would be required to self-assess that province’s provincial component of the HST under this subsection in respect of property and services that relate to the provincial series.

- In the case of provincial investment plans (generally, investment plans or segregated funds created exclusively for investors resident in a single province) - where the provincial investment plan is created for investors resident in a participating province, the provincial investment plan would be required to self-assess that province’s provincial component of the HST under this subsection.

The amendments to subsection 220.08(1) apply in respect of any supply made on or after July 1, 2010.

ETA
220.08(3.1)

Subsection 220.08(3.1) provides that the requirement under subsection 220.08(1) does not apply to a supply of intangible personal property or a service by a participating employer of a pension plan to a pension entity of the same pension plan where the amount of the provincial component of the HST determined under paragraph 172.1(5)(*c*) of the Act (in respect of a supply of the same intangible personal property or service) or under paragraph 172.1(6)(*c*) (in respect of a supply of an employer resource (as referred to in subsection 172.1(6)) consumed or used to make the supply of the same intangible personal property or service) is greater than zero.

Consequential amendments are made to subsection 220.08(3.1) to reflect that the definitions “participating employer”, “pension entity” and “pension plan” are now contained in subsection 123(1) of the Act and apply for the purposes of Part IX of the Act.

The amendments to subsection 220.08(3.1) are deemed to have come into force on September 23, 2009.

Clause 79

Selected Listed Financial Institutions

ETA
225.2

Section 225.2 of the Act sets out rules for determining the net tax of selected listed financial institutions as described in subsection (1) of the section. These special rules provide for adjustments to the net tax of these financial institutions in respect of the provincial component of the HST.

ETA
225.2(1)

Subsection 225.2(1) sets out criteria for determining who is a selected listed financial institution for the purposes of Part IX of the Act. A person is a selected listed financial institution throughout a reporting period in a fiscal year if the person meets two conditions.

- First, the person must be a listed financial institution described in any of subparagraphs 149(1)(*a*)(i) to (x) of the Act during the taxation year in which the fiscal year ends and during the preceding taxation year (as those terms are defined in subsection 123(1) of the Act). A person who is a deemed listed financial institution solely because of an election made under section 150 of the Act does not qualify as a selected listed financial institution.
- Second, the person generally must have been required to allocate taxable income (or, in the case of an individual or a trust, income) to both a participating and a non-participating province in each of those taxation years. Alternatively, the person must either be a specified partnership described in subsection 225.2(8) in each of those taxation years or a prescribed financial institution.

Subsection 225.2(1) is amended in respect of both of these conditions. The first condition is amended to remove the reference to the person’s preceding taxation year so that a person will satisfy the first condition for being a selected listed financial institution throughout a reporting period in a fiscal year if it is a listed financial institution described in any of subparagraphs 149(1)(*a*)(i) to (x) during the taxation year in which the fiscal year ends. The second condition is amended to remove the requirements with respect to allocation of taxable income (or income) and to being a specified partnership and is replaced by a single condition that the person be a financial institution prescribed by regulations throughout the reporting period. Part I of the *Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations* prescribes certain financial institutions for this purpose.

The amendment to subsection 225.2(1) applies in respect of a reporting period of a person that ends on or after July 1, 2010.

ETA
225.2(2)

Subsection 225.2(2) requires a selected listed financial institution to make an adjustment, determined by a formula, to its net tax in respect of the provincial component of the HST for each reporting period during which it is a selected listed financial institution. Generally, paragraph (*a*) of element F of this formula is the total provincial component of the HST that became payable by the financial institution during the period, or was paid by the financial institution during the period without having become payable, in respect of supplies made to the financial institution and in respect of goods imported by the institution.

Paragraph (*a*) is amended to extend the time for a financial institution to include in paragraph (*a*) amounts of the provincial component of the HST that became payable by the financial institution, or was paid by financial institution without having become payable. Instead of being required to include such an amount of the provincial component of the HST only in the particular reporting period of the financial institution in which the amount became payable (or was paid without becoming payable), the financial institution is permitted to include the amount in the particular reporting period or in any other reporting period of the financial institution that ends within two years of the financial institution's fiscal year that includes the particular reporting period, provided

- the financial institution was a selected listed financial institution throughout the particular reporting period;
- the amount was not included in determining the positive or negative amounts determined by the formula in subsection 225.2(2) that the financial institution is required to add, or may deduct, in determining its net tax for a reporting period other than the particular reporting period or the other reporting period, as the case may be; and
- the amount is claimed by the financial institution in its return under Division II of the Act filed by the financial institution for the particular reporting period or the other reporting period, as the case may be.

The amendments to paragraph (*a*) of element F of the formula in subsection 225.2(2) apply in respect of a reporting period of a person that ends on or after July 1, 2010.

As well, paragraph (*b*) of element F of the formula in subsection 225.2(2) is amended only to correct a minor drafting error. This amendment comes into force on Royal Assent.

ETA
225.2(8)

Subsection 225.2(8) defines the term "specified partnership" for the purposes of section 225.2.

The amendment repeals subsection 225.2(8) as the term "specified partnership" is no longer used in the section. The amendment is consequential to the intended enactment of the definition of the similar term "qualifying partnership" in the *Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations*.

The amendment to subsection 225.2(8) is deemed to have come into force on July 1, 2010.

Clause 80

Pre-Approval of Methods for Exchange-traded Funds

ETA
225.3

New section 225.3 of the Act generally allows a selected listed financial institution (as described in subsection 225.2(1) of the Act) that is an exchange-traded fund (generally, an investment plan the units of which are listed or traded on a stock exchange or other public market) to apply to the Minister of National Revenue for authorization to use particular methods to determine, for the purposes of subsection 225.2(2), its percentages for participating provinces for a taxation year of the financial institution. These percentages are used in the formula in subsection 225.2(2) for the purpose of determining the adjustment that the financial institution must, for each reporting period in a fiscal year of the financial institution that ends in the taxation year, make to its net tax in respect of the provincial component of the HST. Section 225.3 is intended to apply in cases where the financial institution is unable to comply with the general requirements of the *Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations* for determining its percentages.

New section 225.3 applies in respect of any fiscal year of a person that ends on or after July 1, 2010.

Definitions

ETA
225.3(1)

Subsection 225.3(1) provides that the terms "exchange-traded fund", "exchange-traded series", "non-stratified investment plan" and "stratified investment plan" have the meaning prescribed by regulations. Under proposed amendments to the *Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations*, those terms would have the same meaning as the proposed definitions of those terms in those Regulations.

Application to Minister

ETA
225.3(2)

Subsection 225.3(2) allows a selected listed financial institution (as described in subsection 225.2(1)) that is an exchange-traded fund to apply to the Minister of National Revenue to use, for the purposes of the formula in subsection 225.2(2), particular methods to determine for a fiscal year of the financial institution that ends in a taxation year of the financial institution,

- where the financial institution is a stratified investment plan (generally, an investment plan the units of which are issued in two or more series), the financial institution's percentages for each exchange-traded series of the financial institution, for each participating province (as defined in subsection 123(1) of the Act) and for the taxation year; and
- where the financial institution is a non-stratified investment plan (generally, an investment plan the units of which are not issued in two or more series), the financial institution's percentages for each participating province and for the taxation year.

Form and Manner of Application to Minister

ETA
225.3(3)

Subsection 225.3(3) provides the form and manner in which an application by a selected listed financial institution under subsection 225.3(2) must be made.

Paragraph 225.3(3)(*a*) requires that the application be made in prescribed form and contain prescribed information. Paragraph 225.3(3)(*a*) also requires that the application specify

- where the financial institution is a stratified investment plan, the particular methods to be used for each exchanged-traded series of the financial institution; and
- where the financial institution is a non-stratified investment plan, the particular methods to be used for the financial institution.

Paragraph 225.3(3)(*b*) requires that the financial institution file its application under subsection 225.3(2) in prescribed manner and that it be filed with the Minister of National Revenue on or before the day that is 180 days before the first day of the fiscal year to which it applies. However, subparagraph 225.3(3)(*b*)(ii) gives the Minister the discretion to allow a financial institution to file the application on a later day.

Authorization

ETA
225.3(4)

Subsection 225.3(4) describes the Minister of National Revenue's authority and obligations in respect of an application made by a selected listed financial institution under subsection 225.3(2). It requires the Minister to consider the application and to either authorize or deny the use of the particular methods specified in the application. Subsection 225.3(4) also requires the Minister to provide notice, in writing, of the decision to the financial institution on or before the day that is the later of the day that is 180 days after the Minister receives the application and the day that is 180 days before the first day of the fiscal year to which the application applies. This deadline can be extended to a later day that the Minister may specify, provided the financial institution makes a written application setting out this later day and files it with the Minister.

Effect of Authorization

ETA
225.3(5)

Subsection 225.3(5) sets out the consequences that apply if the Minister of National Revenue has, under subsection 225.3(4), authorized the use of particular methods specified in an application made by a selected listed financial institution under subsection 225.3(2) for a fiscal year of the financial institution.

Paragraph 225.3(5)(*a*) provides that, despite Part 2 of the *Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations*, for the purposes of the formula in subsection 225.2(2),

- the financial institution's percentages for any participating province and for the taxation year in which the fiscal year ends that would, in the absence of this section, be determined under Part 2 of those Regulations, are instead to be determined in accordance with the particular methods; and
- the financial institution's percentages for any exchange-traded series of the financial institution, for any participating province and for the taxation year in which the fiscal year ends that would, in the absence of this section, be determined under Part 2 of those Regulations, are instead to be determined in accordance with the particular methods.

Paragraph 225.3(5)(*b*) provides that the methods indicated in the application to determine the percentages referred to in paragraph 225.3(5)(*a*) are to be used consistently by the financial institution throughout the fiscal year to which they apply.

Revocation

ETA
225.3(6)

Subsection 225.3(6) provides for circumstances whereby an authorization granted to a selected listed financial institution by the Minister of National Revenue under subsection 225.3(4) in respect of a fiscal year of the financial institution ceases to have effect and is deemed never to have been granted.

Under paragraphs 225.3(6)(*a*) and (*b*), an authorization granted under subsection 225.3(4) to a financial institution in respect of a particular fiscal year will cease to have effect where either the Minister or the financial institution wishes to revoke the authorization and therefore end the effect of that authorization. The Minister may revoke the authorization in respect of a particular fiscal year by sending a notice of revocation to the financial institution on or before the day that is 60 days before the first day of the particular fiscal year. Alternatively, the financial institution may revoke the authorization in respect of a particular fiscal year by filing in prescribed manner with the Minister a notice of revocation in prescribed form containing prescribed information, provided that the notice is filed with the Minister on or before the first day of the particular fiscal year.

Non-residents

ETA
225.4

New section 225.4 of the Act provides a "deemed resident rule" which would apply to a selected listed financial institution (as described in subsection 225.2(1) of the Act) that is an investment plan (which, for the purposes of this section, includes both investment plans described in subsection 149(5) of the Act, as well as segregated funds of insurers (as those terms are defined in subsection 123(1) of the Act)), unless the financial institution makes an election for the rule not to apply. This rule would generally apply for the purposes of determining the financial institution's provincial attribution percentages for the purposes of section 225.2 of the Act, its input tax credit entitlements and its self-assessment of GST for imported taxable supplies under Division IV of Part IX of the Act. Under this rule, units of the financial institution held by non-residents would be treated as units held by Canadian residents and non-resident members of the financial institution would be treated as Canadian resident members.

New section 225.4 applies in respect of any fiscal year of a person that ends on or after July 1, 2010. However, a transitional rule applies for new paragraph 225.4(8)(*c*), as explained in the description of subsection 225.4(8).

Definitions

ETA
225.4(1)

Subsection 225.4(1) contains definitions that are used throughout section 225.4.

"business input"

The term "business input" has the same meaning as in subsection 141.02(1) of the Act and generally means any property or service acquired by a person.

"Canadian activity"

The term "Canadian activity" has the same meaning as in section 217 of the Act and means any activity of a person carried on, engaged in or conducted in Canada.

"exclusive input"

An "exclusive input" of a person is property or a service that is acquired, imported or brought into a participating province by the person for consumption or use directly and exclusively for the purpose of making taxable supplies for consideration or directly and exclusively for purposes other than making taxable supplies for consideration. It is important to note that, as defined in subsection 123(1) of the Act, the term "exclusive" means 100% in the case of financial institutions.

Prescribed definitions

ETA
225.4(2)

Subsection 225.4(2) of the Act provides that the terms “exchange-traded fund”, “exchange-traded series”, “individual”, “investment plan”, “non-stratified investment plan”, “plan member”, “private investment plan”, “series”, “specified investor”, “stratified investment plan” and “unit” have the meaning prescribed by regulations. Under proposed amendments to the *Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations*, those terms would have the same meaning as the proposed definitions of those terms in those Regulations.

Stratified investment plans

ETA
225.4(3)

Subsection 225.4(3) of the Act provides rules that apply in respect of units of a stratified investment plan (generally, an investment plan the units of which are issued in two or more series) that are held by persons that are not resident in Canada. Subsection 225.4(3) applies where the stratified investment plan is a selected listed financial institution throughout a fiscal year of the investment plan and applies in respect of each series of the investment plan for which no election under subsection 225.4(6) of the Act is in effect in respect of the series throughout the fiscal year.

Where subsection 225.4(3) applies in respect of a series of an investment plan for a fiscal year of the investment plan that ends in a calendar year, the following rules apply:

- Paragraph 225.4(3)(*a*) provides that, for the purposes of the *Selected Listed Financial Institution Attribution Method (GST/HST) Regulations*,
  - where the series is an exchange-traded series (generally, a series the units of which are listed or traded on a stock exchange or other public market), all units of the series — that are held at a particular time in the fiscal year by a person that the investment plan knows, as of December 31 of the calendar year, to have not been resident in Canada at the particular time — are deemed to be held, at the particular time, by an individual that is resident in Canada but not resident in any participating province (and the investment plan is deemed to know, on December 31 of the calendar year, the province in which the individual is resident); and
  - where the series is not an exchange-traded series, all units of the series — that are held at a particular time in the fiscal year by a person that is an individual or a specified investor of the investment plan and that the investment plan knows, as of December 31 of the calendar year, to have not been resident in Canada at the particular time — are deemed to be held, at the particular time, by an individual that is resident in Canada but not resident in any participating province (and the investment plan is deemed to know, on December 31 of the calendar year, the province in which the individual is resident).

  The effect of paragraph 225.4(3)(*a*) is that most units of the series that are held by non-resident investors would be included in the calculation of the series’ provincial percentages but would not attract the provincial component of the HST.
- Paragraph 225.4(3)(*b*) provides that, for the purposes of determining an input tax credit of the investment plan, any supply made during the fiscal year by the investment plan in respect of the units of the series of the investment plan that are held by non-resident investors is deemed to have been made to a person resident in Canada. As a result, for example, the investment plan could not claim an input tax credit for making a supply of a financial service to these non-resident investors.
- Paragraph 225.4(3)(*c*) provides that, for purposes of the definitions “external charge” and “qualifying consideration” in section 217 of the Act, any outlay made, or expense incurred, by the investment plan

during the fiscal year in respect of the units of the series of the investment plan that are held by non-resident investors is deemed to be in respect of a Canadian activity of the investment plan (and therefore potentially subject to tax under section 218.01 of the Act where the investment plan is a "qualifying taxpayer" under subsection 217.1(1) of the Act at the time the outlay is made or expense incurred, as the case may be).

  - However, the units of the series of the investment plan that are held by non-resident investors would still be considered to be held by non-resident persons for the purposes of determining if the investment plan is a qualifying taxpayer.

- Paragraph 225.4(3)(*d*) provides that no input tax credit would be claimable by the investment plan in respect of tax in respect of a business input of the investment plan that became payable, or that was paid without having become payable, if
  - the business input is acquired or imported for consumption, use or supply in the course of any activity relating to the series; or
  - the business input is not an exclusive input of the investment plan.

Non-stratified investment plans

ETA
225.4(4)

Subsection 225.4(4) of the Act provides rules that apply in respect of units of a non-stratified investment plan (generally, an investment plan the units of which are not issued in two or more series) that are held by persons that are not resident in Canada. Subsection 225.4(4) applies where the non-stratified investment plan is a selected listed financial institution throughout a fiscal year of the investment plan and where no election under subsection 225.4(7) of the Act is in effect in respect of the investment plan throughout the fiscal year.

Where subsection 225.4(4) applies in respect of an investment plan for a fiscal year of the investment plan that ends in a calendar year, the following rules apply:

- Paragraph 225.4(4)(*a*) provides that, for the purposes of the *Selected Listed Financial Institution Attribution Method (GST/HST) Regulations*,
  - where the investment plan is an exchange-traded fund (generally, an investment plan the units of which are listed or traded on a stock exchange or other public market), all units of the investment plan — that are held at a particular time in the fiscal year by a person that the investment plan knows, on December 31 of the calendar year, to have not been resident in Canada at the particular time — are deemed to be held, at the particular time, by an individual that is resident in Canada but not resident in any participating province (and the investment plan is deemed to know, on December 31 of the calendar year, the province in which the individual is resident); and
  - where the investment plan is not an exchange-traded fund, all units of the investment plan — that are held at a particular time in the fiscal year by a person that is an individual or a specified investor of the investment plan and that the investment plan knows, as of December 31 of the calendar year, to have not been resident in Canada at the particular time — are deemed to be held, at the particular time, by an individual that is resident in Canada but not resident in any participating province (and the investment plan is deemed to know, on December 31 of the calendar year, the province in which the individual is resident);

  The effect of paragraph 225.4(4)(*a*) is that most units of the investment plan that are held by non-resident investors would be included in the calculation of the investment plan's provincial percentages but would not attract the provincial component of the HST.

- Paragraph 225.4(4)(*b*) provides that, for the purposes of determining an input tax credit of the investment plan, any supply made during the fiscal year by the investment plan in respect of the units of the investment plan that are held by non-resident investors is deemed to have been made to a person resident in Canada. As a result, for example, the investment plan could not claim an input tax credit for making a supply of a financial service to these non-resident investors.

- Paragraph 225.4(4)(*c*) provides that, for purposes of the definitions “external charge” and “qualifying consideration” in section 217 of the Act, any outlay made, or expense incurred, by the investment plan during the fiscal year in respect of the units of the investment plan that are held by non-resident investors is deemed to be in respect of a Canadian activity of the investment plan (and therefore potentially subject to tax under section 218.01 of the Act where the investment plan is a “qualifying taxpayer” under subsection 217.1(1) of the Act at the time the outlay is made or expense incurred, as the case may be).
    - However, the units of the investment plan that are held by non-resident investors would still be considered to be held by non-resident persons for the purposes of determining if the investment plan is a qualifying taxpayer.
- Paragraph 225.4(4)(*d*) provides that no input tax credit would be claimable by the investment plan in respect of tax in respect of a business input of the investment plan that became payable, or that was paid without having become payable, if the business input is not an exclusive input of the investment plan.

Pension entities and private investment plans

ETA
225.4(5)

Subsection 225.4(5) of the Act provides rules that apply in respect of plan members of an investment plan that is a pension entity (as defined in subsection 123(1) of the Act) or a private investment plan (generally, an investment plan which does not sell units to the public such as a trust governed by a deferred profit sharing plan or a retirement compensation arrangement) that are not resident in Canada. Subsection 225.4(5) applies where an investment plan is both a pension entity or a private investment plan and a selected listed financial institution throughout a fiscal year of the investment plan and where no election under subsection 225.4(7) of the Act is in effect in respect of the investment plan throughout the fiscal year.

Where subsection 225.4(5) applies in respect of an investment plan for a fiscal year of the investment plan that ends in a calendar year, the following rules apply:

- Paragraph 225.4(5)(*a*) provides that, for the purposes of the *Selected Listed Financial Institution Attribution Method (GST/HST) Regulations*, all plan members of the investment plan — that are persons that the investment plan knows, on December 31 of the calendar year, to have not been resident in Canada at a particular time in the fiscal year — are deemed to be, at the particular time, resident in Canada but not resident in any participating province (and the investment plan is deemed to know, on December 31 of the calendar year, the province in which the person is resident). The effect of paragraph 225.4(5)(*a*) is that members of the investment plan that are non-residents would be included in the calculation of the investment plan’s provincial percentages but would not attract the provincial component of the HST.
- Paragraph 225.4(5)(*b*) provides that, for the purposes of determining an input tax credit of the investment plan, any supply made during the fiscal year by the investment plan in respect of its non-resident plan members is deemed to have been made to a person resident in Canada. As a result, for example, the investment plan could not claim an ITC for making a supply of a financial service to these non-resident plan members.
- Paragraph 225.4(5)(*c*) provides that, for purposes of the definitions “external charge” and “qualifying consideration” in section 217 of the Act, any outlay made, or expense incurred, by the investment plan during the fiscal year in respect of the non-resident plan members is deemed to be in respect of a Canadian activity of the investment plan (and therefore potentially subject to tax under section 218.01 of the Act where the investment plan is a “qualifying taxpayer” under subsection 217.1(1) of the Act at the time the outlay is made or expense incurred, as the case may be).

  - However, the non-resident plan members of the investment plan would still be considered to be non-resident persons for the purposes of determining if the investment plan is a qualifying taxpayer.
- Paragraph 225.4(5)(*d*) provides that no input tax credit would be claimable by the investment plan in respect of tax in respect of a business input of the investment plan that became payable, or that was paid without having become payable, if the business input is not an exclusive input of the investment plan.

Election — Stratified investment plans

ETA
225.4(6)

Subsection 225.4(6) of the Act allows a stratified investment plan to make an election in respect of a series of the investment plan to have subsection 225.4(3) of the Act not apply to the series for fiscal years of the investment plan. An election under subsection 225.4(6) is to be effective from the first day of a fiscal year of the investment plan.

Election — Other investment plans

ETA
225.4(7)

Subsection 225.4(7) of the Act allows an investment plan that is a non-stratified investment plan, a pension entity or a private investment plan to make an election to have subsection 225.4(4) (in the case of a non-stratified investment plan) or 225.4(5) (in the case of a pension entity or a private investment plan) of the Act not apply to the investment plan for fiscal years of the investment plan. An election under subsection 225.4(6) is to be effective from the first day of a fiscal year of the investment plan.

Form of election

ETA
225.4(8)

Subsection 225.4(8) of the Act provides the requirements that an investment plan must meet to make an election under subsection 225.4(6) or (7).

Paragraph 225.4(8)(*a*) requires that the election be made in prescribed form and contain prescribed information. Paragraph 225.4(8)(*b*) requires that the election set out the first fiscal year of the investment plan during which the election is to be in effect. As well, to be a valid election under subsection 225.4(6) or (7), the election must conform with the restriction in subsection 225.4(11) of the Act with respect to the effective date set out in an election not being less five years after the effective date of a revocation of an election made under the same subsection.

Paragraph 225.4(8)(*c*) requires that the election be filed with the Minister of National Revenue in prescribed manner on or before the first day of the first fiscal year of the investment plan during which the election is to be in effect. However, in the case of an election for any fiscal year that begins before March 1, 2011, paragraph 225.4(8)(*c*) instead requires that the election be filed on or before March 1, 2011. Nevertheless, this paragraph gives the Minister the discretion to allow the investment plan to file the election on a later day.

Cessation

ETA
225.4(9)

Subsection 225.4(9) of the Act provides the circumstances under which an election made under subsection 225.4(6) or (7) by an investment plan ceases to have effect. Under subsection 225.4(9), an election under subsection 225.4(6) or (7) ceases to have effect on the earliest of

- the first day of the fiscal year of the investment plan in which the investment plan ceased to be a selected listed financial institution;
- in the case of an election made under subsection 225.4(6), the first day of the fiscal year of the investment plan in which the investment plan ceases to be a stratified investment plan;
- in the case of an election made under subsection 225.4(7), the first day of the fiscal year of the investment plan in which the investment plan ceases to be a non-stratified investment plan, a pension entity or a private investment plan, as the case may be; and
- the day on which a revocation of the election under subsection 225.4(10) becomes effective.

Revocation

ETA
225.4(10)

Subsection 225.4(10) of the Act allows an investment plan to revoke an election that is made under subsection 225.4(6) or (7). Once an election is revoked under subsection 225.4(10), that election ceases to have effect from the time the revocation becomes effective, which is the first day of the fiscal year of the investment plan that it specifies in the revocation. However, a revocation of an election made under subsection 225.4(6) or (7) cannot become effective earlier than the day that is the first day of a fiscal year of the investment plan that begins at least five years after the day on which the election became effective (i.e., the first day of the fiscal year specified in accordance with paragraph 225.4(8)(*b*) in the election filed by the investment plan). Nevertheless, the Minister of National Revenue has the discretion to allow, on application of the investment plan, the revocation to be effective on the first day of any earlier fiscal year of the investment plan.

In order to revoke an election made under subsection 225.4(6) or (7), subsection 225.4(10) requires that the investment plan file a notice of revocation in prescribed form containing prescribed information. The notice must be must be filed in prescribed manner with the Minister of National Revenue no later than the day on which the revocation is to become effective.

Restriction

ETA
225.4(11)

Subsection 225.4(11) of the Act provides that where an investment plan has made an election under subsection 225.4(6) in respect of a series of the investment plan or under subsection 225.4(7) in respect of the investment plan and the investment plan has revoked that election under subsection 225.4(10) with the revocation being effective on a particular day, any subsequent election under subsection 225.4(6) in respect of the same series or under subsection 225.4(7) by the investment plan cannot become effective under subsection 225.4(6) or (7), as the case may be, before the day that is five years after the particular day. However, subsection 225.4(11) provides the Minister of National Revenue the discretion to allow, on application by the investment plan, the subsequent election to be effective on an earlier day.

Clause 81

Definitions

ETA
232.01(1)

Subsection 232.01(1) of the Act provides that certain terms used in sections 232.01 and 232.02 have the same meanings as in sections 172.1, 259 and 261.01 of the Act. Paragraph 232.01(1)(*a*) provides that in sections 232.01 and 232.02 the terms “employer resource”, “participating employer”, “pension entity”, “pension plan” and “specified resource” have the same meanings as in section 172.1.

Consequential amendments are made to paragraph 232.01(1)(*a*) to remove the reference to the terms "participating employer", "pension entity" and "pension plan". The amendments reflect that these terms are now defined in subsection 123(1) of the Act for the purposes of Part IX of the Act.

The amendments to paragraph 232.01(1)(*a*) are deemed to have come into force on September 23, 2009.

Clause 82

Registration

ETA
240

Existing section 240 of the Act sets out the registration requirements that apply for purposes of the GST/HST.

Section 240 is amended to add new subsections 240(1.2), (1.3) and (1.4) and to amend subsections 240(2.1), (3) and (5). These amendments generally allow groups of selected listed financial institutions (as described in subsection 225.2(1) of the Act) that are prescribed to make a single registration as a group and require prescribed selected listed financial institutions to register for the GST/HST.

The amendments to section 240 are deemed to have come into force on July 1, 2010.

ETA
240(1.2)

New subsection 240(1.2) of the Act requires every selected listed financial institution that is prescribed by regulations to be registered for the purposes of Part IX of the Act. Under proposed regulations, a selected listed financial institution would generally be prescribed if it is an investment plan (as described in subsection 149(5) of the Act) or a segregated fund of an insurer (as defined in subsection 123(1) of the Act) that has made certain reporting elections that would allow its manager to report and remit tax on its behalf.

ETA
240(1.3)

New subsection 240(1.3) of the Act provides rules which apply in respect of a group of selected listed financial institutions prescribed by regulations. Under proposed regulations, a prescribed group would generally be a group of investment plans or segregated funds of an insurer, each of which has the same manager, that has elected with the manager to file their GST/HST returns on a consolidated basis. These rules provide that:

- the group is required to be registered for the purposes of Part IX of the Act;
- a person that is prescribed in respect of the group (under proposed regulations, this would be the manager of the financial institutions in the group) must apply to the Minister of National Revenue for registration of the group before the day that is prescribed (under proposed regulations, this would be the day that is thirty days after the day on which the consolidated filing election, which created the group, comes into effect); and
- each financial institution in the group is deemed to be a registrant for the purposes of Part IX and, despite subsections 240(1) to (1.2) of the Act, is not required to be separately registered.

ETA
240(1.4)

New subsection 240(1.4) of the Act provides rules relating to the addition to a group registration under subsection 240(1.3) of a selected listed financial institution that is an investment plan or a segregated fund of an insurer that becomes a member of an existing group. In particular, these rules provide that:

- if the group is required to be registered under subsection 240(1.3), the application for registration of the group under paragraph 240(1.3)(*b*) must list the financial institution as a member of the group;

- if the group is registered, either the financial institution or the person that is prescribed in respect of the group must apply to the Minister of National Revenue for the financial institution to be added to the registration of the group. This application must be made before the day that is thirty days after the day the financial institution became a member of the group; and
- the financial institution is deemed to be, as of the day on which it became a member of the group, a registrant for the purposes of Part IX and, despite subsections 240(1) to (1.2) of the Act, is not required to be separately registered.

ETA
240(2.1)

Subsection 240(2.1) of the Act requires registrants to file an application for registration with the Minister of National Revenue.

Subsection 240(2.1) is amended to add new paragraph 240(2.1)(*a*.1), which requires a selected listed financial institution that is required by new subsection 240(1.2) of the Act to be registered for the purposes of Part IX of the Act to apply to the Minister of National Revenue to be registered before the day that is thirty days after the day that is prescribed by regulations. Under proposed regulations, this day would be the day on which an election to allow the manager of the financial institution to report and remit tax on its behalf comes into effect. Paragraph 240(2.1)(*b*) of the French version of the Act is also amended to ensure consistency with other provisions of the Act.

ETA
240(3)

Subsection 240(3) of the Act permits persons engaged in a commercial activity in Canada and certain other specified persons to apply to become registered for purposes of the GST/HST. Subsection 240(3) applies only to persons not otherwise required to register under subsection 240(1), (1.1), (2) or (4) of the Act.

Subsection 240(3) is amended to provide that it also does not apply to persons required to register under new subsection 240(1.2) of the Act or that are required to be included in, or added to, an application for registration of a group under new subsection 240(1.3) or (1.4) of the Act.

ETA
240(5)

Subsection 240(5) of the Act provides that an application for registration must be filed in prescribed form and manner.

Subsection 240(5) is amended so that it also applies to an application to add a person to a registration of a group, as provided for under new paragraph 240(1.4)(*b*) of the Act.

Clause 83

Registration

ETA
241

Existing section 241 provides authority for the Minister of National Revenue to register a person applying for registration for GST/HST purposes.

Section 241 is amended to amend subsection 241(1) and to add new subsections 241(1.1) and (1.2). These amendments allow for registration by the Minister of certain groups of selected listed financial institutions prescribed by regulations.

The amendments to section 241 are deemed to have come into force on July 1, 2010.

ETA
241(1)

Existing subsection 241(1) provides authority to the Minister of National Revenue to issue a registration number to an applicant identifying the person as a registrant for GST/HST purposes, along with written confirmation of the effective date of the registration.

Subsection 241(1) is amended only to update its wording in accordance with current legislative drafting standards.

ETA
241(1.1)

New subsection 241(1.1) provides that the Minister of National Revenue may register a group of selected listed financial institutions (as described in subsection 225.2(1) of the Act) that is prescribed by regulations for the purposes of new subsection 240(1.3) of the Act upon application of a person that is prescribed in respect of the group. Under proposed regulations, a prescribed group would be a group of investment plans or segregated funds of an insurer, each of which has the same manager, which has elected with the manager to file their GST/HST returns on a consolidated basis. The manager would be the person that is prescribed in respect of the group. Where the Minister registers the group, the following rules apply:

- the Minister must assign a registration number to the group and notify in writing the person that is prescribed in respect of the group and each financial institution listed on the application of both the registration number and the effective date of the registration of the group;
- where a financial institution that is a member of the group was already individually registered for GST/HST purposes, that registration is deemed to be cancelled as of the effective date of the registration of the group; and
- each member of the group is deemed, for the purposes of Part IX of the Act (other than for section 242), to be registered for GST/HST purposes as of the effective date of the registration of the group and to have a registration number that is the same as the registration number of the group.

ETA
241(1.2)

New subsection 241(1.2) provides that, where an application is made under new paragraph 240(1.4)(*b*) of the Act to add a selected listed financial institutions to an existing registration of a group, the Minister of National Revenue may add the financial institution to the registration of the group. Where the Minister adds the financial institution to the group registration, the following rules apply:

- the Minister must notify in writing both the person that is prescribed in respect of the group and the financial institution of the effective date of the addition of the financial institution to the registration of the group;
- where the financial institution was already individually registered for GST/HST purposes, that registration is deemed to be cancelled as of the effective date of the addition of the financial institution to the registration of the group; and
- the financial institution is deemed, for the purposes of Part IX of the Act (other than for section 242), to be registered for GST/HST purposes as of the effective date of the addition of the financial institution to the registration of the group and to have a registration number that is the same as the registration number of the group.

Clause 84

Cancellation of Registration

ETA
242

Existing section 242 deals with the cancellation by the Minister of National Revenue of a registration for GST/HST purposes of a person.

Section 242 is amended to add new subsections 242(1.1), (1.2), (1.3), (1.4), (4) and (5) and to amend subsection 242(3). These amendments allow for cancellation of a registration by the Minister of certain groups of prescribed persons.

The amendments to section 242 are deemed to have come into force on July 1, 2010.

ETA
242(1.1)

New subsection 242(1.1) provides that the Minister of National Revenue may cancel a group registration made under subsection 241(1.1) of the Act where the Minister is satisfied that the registration is not required for the purposes of Part IX of the Act. The Minister may only cancel the registration of the group after giving reasonable written notice to each member of the group and to the person that is prescribed by regulations in respect of the group for the purposes of paragraph 240(1.3)(*b*). Under proposed regulations, the person that is prescribed in respect of the group would be the manager of the investment plans and segregated funds of insurers in the group.

ETA
242(1.2)

New subsection 242(1.2) provides that the Minister of National Revenue must cancel the registration of a group made under subsection 241(1.1) of the Act in circumstances prescribed by regulations. Under proposed regulations, the revocation of a consolidated filing election, which created the group of selected listed financial institutions that is prescribed for the purposes of new subsection 240(1.3) of the Act, would be a prescribed circumstance.

ETA
242(1.3)

New subsection 242(1.3) provides that the Minister of National Revenue may remove a particular person that is a member of a group that is registered for purposes of the GST/HST if the Minister is satisfied that the particular person is not required to be included in the registration of the group for those purposes. The Minister may only remove the particular person after giving reasonable written notice to the particular person and to the person that is prescribed in respect of the group for the purposes of paragraph 240(1.3)(*b*).

ETA
242(1.4)

New subsection 242(1.4) provides that the Minister of National Revenue must remove a particular person from the registration of a group in circumstances prescribed by regulations. Under proposed regulations, the withdrawal of the particular person from the consolidated filing election that created the group would be a prescribed circumstance.

ETA
242(3)

Subsection 242(3) provides that where the registration of a person is cancelled by the Minister, written notice is to be given to the person of the cancellation and its effective date.

Subsection 242(3) is amended only to update its wording in accordance with current legislative drafting standards.

ETA
242(4)

New subsection 242(4) requires the Minister of National Revenue to notify in writing each member of a group, and the person that is prescribed in respect of the group for the purposes of paragraph 240(1.3)(*b*) of a cancellation of the registration of the group and of the effective date of the cancellation. Subsection 242(4) also provides that each member of the group is deemed to no longer be registered for GST/HST purposes as of the effective date of the cancellation.

ETA
242(5)

New subsection 242(5) requires the Minister of National Revenue to notify in writing a particular person that is a member of a group, and the person that is prescribed in respect of the group for the purposes of paragraph 240(1.3)(*b*), of the removal of the particular person from the registration of the group and of the effective date of the removal. Subsection 242(5) also provides that the particular person is deemed to no longer be registered for GST/HST purposes as of the effective date of the cancellation.

Clause 85

Fiscal Year

ETA
244.1

New section 244.1 of the Act generally provides that, despite other provisions of Part IX of the Act, the fiscal year (as defined in subsection 123(1) of the Act) of a selected listed financial institution (as described in subsection 225.2(1) of the Act) that is either an investment plan (as defined in subsection 149(5) of the Act) or a segregated fund of an insurer (as those terms are defined in subsection 123(1)) is a calendar year.

New section 244.1 applies in respect of a fiscal year of a person that ends after 2010. However, a transitional rule applies for new subsection 244.1(1) in respect of a fiscal year that begins before 2011, as explained in the description of that subsection.

ETA
244.1(1)

Subsection 244.1(1) of the Act provides that if, throughout a particular reporting period in a particular fiscal year of a person that begins in a particular calendar year, the person is both

- a selected listed financial institution; and
- either an investment plan or a segregated fund of an insurer,

the following rules apply:

- Any election made by the person under section 244 of the Act ceases to have effect. An election under section 244 allows certain persons to elect to have a fiscal year for GST/HST purposes that is different from the taxation year of the person for the purposes of the *Income Tax Act*.
- Where the person was a selected listed financial institution throughout the reporting period immediately before the particular reporting period, the fiscal years of the person are calendar years.
- Where the person was not a selected listed financial institution throughout the reporting period immediately before the particular reporting period
    - the particular fiscal year ends as of the last day of the particular calendar year; and

  - effective as of the first day of the calendar year that is immediately after the particular calendar year, the fiscal years of the person are calendar years.

- A transitional rule applies where the particular fiscal year begins before 2011, irrespective of whether the person was a selected listed financial institution throughout the reporting period immediately before the particular reporting period. This rule provides that that particular fiscal year ends on December 31, 2010 and, effective as of January 1, 2011, the fiscal years of the person are calendar years.

ETA
244.1(2)

Subsection 244.1(2) of the Act generally provides an additional rule for determining the fiscal year of certain persons, which applies despite subsection 244.1(1). Subsection 244.1(2) applies to a person where

- the person is, throughout a particular reporting period in a particular fiscal year of the person, both a selected listed financial institution and either an investment plan or a segregated fund of an insurer; and
- prescribed circumstances exist (for instance, prescribed circumstances could be certain types of merger transactions involving investment plans or segregated funds).

Where subsection 244.1(2) applies to a person,

- the particular fiscal year ends on the day immediately before a prescribed day (for instance, the prescribed day could be the date of the merger transaction); and
- the immediately following fiscal year of the person would begin on the prescribed day.

ETA
244.1(3)

Subsection 244.1(3) of the Act provides a rule applicable where certain persons cease to be selected listed financial institutions.

Subsection 244.1(3) applies if a person is

- throughout a particular reporting period in a particular fiscal year of the person, both a selected listed financial institution and either an investment plan or a segregated fund of an insurer; and
- not a selected listed financial institution throughout a reporting period in the following fiscal year of the person.

Subsection 244.1(3) provides that the following fiscal year ends on the day on which it would end in the absence of this section.

Clause 86

Election for Fiscal Months

ETA
246

Section 246 of the Act sets out the rules that permit persons who are reporting on a quarterly or annual basis to elect to file on a monthly basis.

Section 246 is amended, by adding new subsection 246(4) and amending subsection 246(3), to permit persons who have made an election under section 246 to revoke this election.

The amendments to section 246 apply to any fiscal year of a person that ends on or after July 1, 2010.

ETA
246(3)

Subsection 246(3) provides that the election to file on a monthly basis will remain in effect until it is superseded by an election by the person under section 247 or 248 of the Act for quarterly or annual filing.

Subsection 246(3) is amended to provide that the election to file on a monthly basis will remain in effect until the earlier of

- the day on which an election by the person under section 247 or 248 for quarterly or annual filing takes effect; and
- the day on which a revocation of the election by the person under subsection 246(4) becomes effective.

ETA
246(4)

New subsection 246(4) allows a listed financial institution (as defined in subsection 123(1) of the Act) that has made an election under subsection 246(1) to revoke that election. A revocation under subsection 246(4) is effective on the first day of a fiscal year of the financial institution. The revocation is to be made by filing in prescribed manner with the Minister of National Revenue a notice of revocation in prescribed form containing prescribed information not later than the day on which the revocation is to become effective or any later day that the Minister may allow.

Clause 87

Election for Fiscal Quarters

ETA
247

Section 247 of the Act sets out the rules that permit persons whose revenue in a fiscal year from taxable supplies does not exceed $6 million to elect to file on a quarterly basis.

Section 247 is amended, by adding new subsection 247(3) and amending subsection 247(2), to permit persons who have made an election under section 247 to revoke this election.

The amendments to section 247 apply to any fiscal year of a person that ends on or after July 1, 2010.

ETA
247(2)

Subsection 247(2) provides that the election by a person to file on a quarterly basis will remain in effect until it is superseded by an election by the person under section 246 or 248 for monthly or annual filing or by the threshold amount of the person (as described in section 249 of the Act) exceeding the applicable amount.

Subsection 247(2) is amended to provide that the election to file on a quarterly basis will remain in effect until the earlier of

- the day on which an election by the person under section 246 or 248 for monthly or annual filing takes effect;
- if the person is not a charity, the beginning of the first fiscal quarter for which the threshold amount of the person exceeds $6,000,000;
- if the person is a charity, the beginning of the first fiscal year for which the threshold amount of the person exceeds $6,000,000; and
- the day on which a revocation of the election by the person under subsection 247(3) becomes effective.

ETA
247(3)

New subsection 247(3) allows a listed financial institution (as defined in subsection 123(1) of the Act) that has made an election under subsection 247(1) to revoke that election. A revocation under subsection 247(3) is effective on the first day of a fiscal year of the financial institution. The revocation is to be made by filing in prescribed manner with the Minister of National Revenue a notice of revocation in prescribed form containing prescribed information not later than the day on which the revocation is to become effective or any later day that the Minister may allow.

Clause 88

Definitions

ETA
261.01(1)

Subsection 261.01(1) contains definitions that apply in section 261.01.

Subsection 261.01(1) is amended to repeal the definitions “participating employer”, “pension entity” and “pension plan”. The amendments are consequential to the addition of these definitions to subsection 123(1) of the Act.

The amendments to subsection 261.01(1) are deemed to have come into force on September 23, 2009.

Clause 89

Rebate in Respect of Intangible Personal Property or Services Supplied in a Participating Province

ETA
261.3

Section 261.3 of the Act provides for a rebate of the provincial component of the HST paid on supplies of intangible personal property or services to the extent that the property or service is acquired by the recipient of the supply for consumption, use or supply outside the participating provinces. The rebate is provided for in subsection 261.3(1) while subsection 261.3(2) provides that the rebate is not payable to listed financial institutions (as defined in subsection 123(1) of the Act) that is an investment plan (as defined in subsection 149(5) of the Act) or a segregated fund of an insurer (as those terms are defined in subsection 123(1) of the Act) in respect of certain supplies.

Section 261.3 is amended to repeal subsection 261.3(2), as the rebate restriction in that subsection is now provided for in new subsection 261.4(2) of the Act.

The amendment to section 261.3 is deemed to have come into force on July 1, 2010.

Clause 90

Rebate for Tax Payable by Investment Plans

ETA
261.31

Section 261.31 of the Act allows an investment plan (as described in subsection 149(5) of the Act) or a segregated fund of an insurer (as defined in subsection 123(1) of the Act) to claim a rebate of the provincial component of the HST payable in respect of certain supplies. The rebate is limited to investment plans and segregated funds that are not selected listed financial institutions (as described in subsection 225.2(1) of the Act) and to tax payable in respect of supplies of “specified services”, which are generally defined in subsection 261.31(1) as management and administrative services.

Section 261.31 is amended by repealing subsection 261.31(1) and to amend subsection 261.31(2), (3) and (5). The amendments to section 261.31 allow the rebate to be claimed in respect of amounts of the provincial component of the HST in respect of all supplies of property or services, not just in respect of supplies of specified services. As well, the amendments allow persons prescribed by regulations to claim the rebate in certain circumstances. Under proposed regulations, prescribed persons would generally be certain investment plans or segregated funds that are selected listed financial institutions and that have provincial series created exclusively for investors resident in a single province.

The amendments to section 261.31 apply in respect of any rebate that is in respect of tax that became payable or was paid without having become payable on or after July 1, 2010.

ETA
261.31(1)

Subsection 261.31(1) defines a “specified service” for the purpose of section 261.31 as any management or administrative service and any other service provided to the plan or fund by a person who also supplies management and administrative services to it.

Subsection 261.31(1) is repealed as the term “specified service” is no longer used in section 261.31.

ETA
261.31(2)

Subsection 261.31(2) provides a rebate to investment plans and segregated funds that are not selected listed financial institutions of the provincial component of the HST payable under subsection 165(2) or 218.1(1) or section 220.08 on supplies of specified services. The rebate is payable where prescribed conditions, if any, are satisfied (currently, no conditions are prescribed) and the restrictions in section 261.4 of the Act do not apply to deny the rebate. The amount of the rebate is to be determined in prescribed manner.

Subsection 261.31(2) is amended in three ways. Firstly, subsection 261.31(2) is amended to provide that the rebate can also be claimed by persons prescribed by regulations. Under proposed regulations, a prescribed person would generally be an investment plan or segregated fund that is a selected listed financial institution that has one or more provincial series created exclusively for investors resident in a single province. Secondly, subsection 261.31(2) is amended to provide that the rebate can also be claimed in respect of the provincial component of the HST payable under sections 212.1 and 218.1 and Division IV.1 of the Act. Thirdly, subsection 261.31(2) is amended to provide that the rebate can be claimed in respect of the provincial component of the HST payable by a claimant on all supplies, not just supplies of specified services.

ETA
261.31(3)

Subsection 261.31(3) allows a segregated fund of an insurer and the insurer to file an election with the Minister of National Revenue to allow the insurer to pay to, or credit in favour of, the segregated fund any rebates payable to the segregated fund under subsection 261.31(2) in respect of supplies of specified services made by the insurer to the segregated fund.

Consequential amendments are made to subsection 261.31(3) to reflect that the rebate provided under subsection 261.31(2) is now in respect of all supplies of property or services, not just supplies of specified services.

ETA
261.31(5)

Subsection 261.31(5) allows an insurer which made an election under subsection 261.31(3) with a segregated fund of the insurer, to pay or credit a rebate that the segregated fund could otherwise have claimed under subsection 261.31(2) in respect of a taxable supply of specified services made by the insurer to the segregated fund.

Consequential amendments are made to subsection 261.31(5) to reflect that the rebate provided under subsection 261.31(2) is now in respect of all supplies of property or services, not just supplies of specified services.

Clause 91

Restriction

ETA
261.4

Section 261.4 of the Act sets out several general restrictions relating to the rebates provided under sections 261.1, 261.2, 261.3 and 261.31 of the Act.

Section 261.4 is amended to renumber the section as subsection 261.4(1) and to add new subsection 261.4(2).

Subsection 261.4(2) contains a restriction, which is additional to the restrictions contained in subsection 261.4(1). It provides that a rebate under any of sections 261.1 to 261.3 of the Act in respect of tax paid or payable by an investment plan (as described by subsection 149(5) of the Act) or a segregated fund of an insurer (as defined in subsection 123(1) of the Act) must not be paid.

The amendments to section 261.4 apply in respect of any rebate that is in respect of tax that became payable or was paid without having become payable on or after July 1, 2010.

Clause 92

Exception — Prescribed Person

ETA
263.01(4)

Subsection 263.01(1) of the Act restricts a person from claiming rebates provided in the Act, and certain refunds or abatements administered under the *Customs Act*, to the extent that these are in respect of the provincial component of the HST that was paid or payable at a time when the person was a selected listed financial institution (as described in subsection 225.2(1) of the Act). This restriction is subject to the exceptions contained in subsections 263.01(2) and (3).

Section 263.01 is amended to add new subsection 263.01(4). Subsection 263.01(4) contains an additional exception to the restriction in subsection 263.01(1). Subsection 263.01(4) provides that a rebate under section 261.31 of the Act in respect of a prescribed amount of tax may be paid to a person that is prescribed by regulations for the purposes of subsection 261.31(2). Under proposed regulations, a person that is prescribed for the purposes of subsection 261.31(2) would be an investment plan (as described in subsection 149(5) of the Act) or a segregated fund of an insurer (as defined in subsection 123(1) of the Act) that is a selected listed financial institution that has one or more provincial series created exclusively for investors resident in a single province. Also, a prescribed amount of tax could be an amount of tax that becomes payable, or that is paid without having become payable, by such a person in respect of a supply that is acquired in whole or in part for consumption, use or supply in the course of activities related to a provincial series of the person.

New subsection 263.01(4) is deemed to have come into force on July 1, 2010.

Jobs and Economic Growth Act

Clause 93

Transitional Rules for Pension Plans

Jobs and Economic Growth Act
58

Section 58 of the *Jobs and Economic Growth Act (the Act)* enacted section 172.1 of the *Excise Tax Act* (ETA) which generally sets out the rules for determining when an employer that is a registrant (as defined in subsection 123(1) of the ETA) will be deemed to have made a supply to a trust governed by, or to a corporation that administers, a pension plan of the employer and for determining the amount of tax to be remitted by the employer on that deemed supply.

Subsection 58(2) of the Act is amended to provide transitional rules that apply in the case of the Nova Scotia component of the HST deemed to have become payable under subsections 172.1(5) to (7) of the ETA for the fiscal year of an employer that includes July 1, 2010, which is the implementation date of the increase of the rate of the Nova Scotia component of the HST from 8 per cent to 10 per cent.

New paragraph 58(2)(*a.1*) of the Act is added to provide a transitional rule for the determination of the Nova Scotia component of the HST in respect of an employer resource supply (as defined in subsection 172.1(1) of the ETA) under subsection 172.1(5) of the ETA. This transitional rule applies where a person that is a participating employer of a pension plan acquires property or a service for the purpose of making a supply of all or part of the property or service to a pension entity of the pension plan (as those terms are defined in subsection 172.1(1) of the ETA) but not for the purpose of making a supply of any part of the property or service to a pension entity of the pension plan after June 2010. Where the transitional rule applies, the amount determined for element B in the formula in paragraph 172.1(5)(*c*) of the ETA for Nova Scotia in respect of a taxable supply of all or part of the property or service that is deemed to have been made under paragraph 172.1(5)(*a*) of the ETA shall be determined on the basis that the tax rate for Nova Scotia is 8 per cent rather than 10 per cent.

Paragraph 58(2)(*b*) of the Act is amended to provide a transitional rule for the determination of the Nova Scotia component of the HST in respect of an employer resource supply under either subsection 172.1(6) or (7) of the ETA. This transitional rule applies for the fiscal year of an employer that begins before July 1, 2010 and ends on or after that day. The transitional rule provides that, for that fiscal year, the Nova Scotia component of the HST in respect of the employer resource supply is adjusted to reflect a rate of only 8 per cent based on the number of days in the fiscal year that are before July 1, 2010.

The amendment comes into force on Royal Assent.

Clause 94

Transitional Rules for Tax in a Participating Province

Jobs and Economic Growth Act
64

Section 64 of the Act amended subsection 218.1(1.2) of the ETA. Subsection 218.1(1.2) of the ETA includes a self-assessment provision in respect of the provincial component of the HST that is generally applicable to qualifying taxpayers (as described in subsection 217.1(1) of the ETA) resident in a participating province.

Subsection 64(8) of the Act is added to provide a transitional rule as a consequence of the increase of the rate of the Nova Scotia component of the HST from 8 per cent to 10 per cent, effective July 1, 2010. This transitional rule applies for a specified year (as defined in section 217 of the ETA) of a qualifying taxpayer that begins before July 1, 2010 and ends on or after that day. It provides that, for that specified year, the provincial component of the HST determined for Nova Scotia (or the Nova Scotia offshore area) under subsection

218.1(1.2) of the ETA is adjusted to reflect a rate of only 8 per cent based on the number of days in the fiscal year that are before July 1, 2010.

The amendment comes into force on Royal Assent.

Clause 95

Transitional Rules for Pension Plan Rebate

Jobs and Economic Growth Act
75

Section 75 of the Act amended section 261.01 of the ETA. Section 261.01 of the ETA provides a GST/HST rebate for pension entities of a pension plan (as those terms are defined in subsection 123(1) of the ETA) and allows a pension entity of a pension plan and the qualifying employers (as defined in subsection 261.01(1) of the ETA) of the pension plan to make a joint election to transfer some or all of the pension entity's rebate entitlement to some or all of the employers.

Subsection 75(4) of the Act is amended to provide transitional rules as a consequence of the increase of the rate of the Nova Scotia component of the HST from 8 per cent to 10 per cent, effective July 1, 2010. Specifically, subsection 75(4) of the Act is amended to provide a transitional rule for the term "provincial pension rebate amount" in subsection 261.01(1) of the ETA. The provincial pension rebate amount is used by a pension entity that is a selected listed financial institution (as described in subsection 225.2(1) of the ETA) throughout a claim period (as defined in subsection 259(1) of the ETA) of the pension entity, in determining the amount of a rebate that may be shared with a participating employer that is a party to an election with the pension entity made for the claim period under any of subsections 261.01(5), (6) or (9) of the ETA. This transitional rule applies for the claim period of a pension entity that begins before July 1, 2010 and ends on or after that day and provides that, where the pension entity is a selected listed financial institution throughout the claim period, the provincial pension rebate amount of the pension entity for the claim period is adjusted to reflect a rate of only 8 per cent based on the number of days in the claim period that are before July 1, 2010.

The amendment comes into force on Royal Assent.

Clause 96

Input Tax Credit Allocation Methods (GST/HST) Regulations

Jobs and Economic Growth Act
91

The *Input Tax Credit Allocation Methods (GST/HST) Regulations* (the Regulations) concerning the claiming of input tax credits by large financial institutions were enacted by section 91 of the Act.

The new provision deems the Regulations made in the Act to have been made under the ETA to clarify that since these Regulations have been made for GST/HST purposes, they are subject to the same regulation-making powers as other regulations made under the ETA for GST/HST purposes.

Since these Regulations were enacted by Parliament, this new provision also confirms that procedural steps under the *Statutory Instruments Act* are deemed to have been made.

The new provision comes into force on Royal Assent.