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

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Preface

These explanatory notes describe proposed amendments to the *Income Tax Act*, the *Excise Tax Act* and the *Income Tax 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.

Table of Contents

Clause in Legislation	Section Amended	Topic	Page
		Part 1 – Amendments to the Income Tax Act and the Income Tax Regulations	
Income Tax Act			
2	10	Valuation of inventory – loss restriction event	7
3	11	Proprietor of business	8
4	12	Income inclusions	8
5	12.6	Stapled securities – anti-avoidance	10
6	13	Depreciable property	13
7	14	Eligible capital property	15
8	18	Prohibited deductions	15
9	18.1	Matchable expenditure	22
10	18.3	Stapled securities	22
11	20	Deductions	27
12	20.01	Private health services plan	30
13	28	Farming or fishing business	30
14	31	Restricted farm loss	30
15	34.1	Deemed December 31, 1995 income	31
16	34.2	Corporate partners	32
17	36	Railway companies	36
18	37	Scientific research and experimental development	37
19	40	Capital gains and losses – general rules	37
20	44	Where a reserve may not be claimed	39
21	50	Debts established to be bad debts and shares of bankrupt corporation	39
22	53	Adjustments to cost base	39
23	54	Definition “superficial loss”	42
24	55	Anti-avoidance – capital gains stripping	42
25	56	Amounts to be included in income	49
26	60	Refund of income payments	49
27	60.001	Support payments	50
28	60.1	Support payments	50
29	60.11	Support payments	50
30	66	Resource expenses	51
31	66.1	Canadian exploration expense	53
32	66.2	Canadian development expense	55
33	67.1	Exemption for expenses for food, etc.	56
34	70	Death of a taxpayer	56

Clause in Legislation	Section Amended	Topic	Page
35	75	Revocable trusts and exceptions	57
36	80	Debt forgiveness	57
37	80.04	Agreement respecting transfer of forgiven amount	59
38	80.6	Synthetic disposition – deemed disposition	60
39	87	Rules applicable to amalgamations	61
40	88	Winding-up	62
41	89	Definitions	71
42	94	Non-resident trusts	72
43	96	Members deemed carrying on business	74
44	107	Distributions from a trust	75
45	107.3	Ceasing to be a qualifying environmental trust	76
46	110.6	Lifetime capital gains exemption	76
47	111	Loss restriction event – losses	79
48	112	Synthetic disposition – holding period	81
49	117.1	Annual adjustment	82
50	118.5	Inclusion of ancillary fees and charges	82
51	122.1	SIFT trusts	82
52	122.61	Canada child tax benefit – non-residents and part-year residents	84
53	122.64	Canada child tax benefit – communication of information	84
54	123.4	Definitions	85
55	125	Specified partnership income	86
56	126	Synthetic disposition – holding period	87
57	127	Deductions from Part I tax	88
58	127.1	Refundable investment tax credit	90
59	127.4	Deduction of labour-sponsored funds tax credit	90
60	127.52	Adjusted taxable income determined	91
61	136	Cooperative corporations	92
62	137	Credit unions	93
63	142.2	Mark-to-market property	94
64	147.1	Reasonable error	94
65	148	Policy dispositions	95
66	149	Becoming or ceasing to be exempt	96
67	152	Assessment and reassessment	96
68	156	Instalments for individuals	98
69	157	Payment by corporation	98
70	162	Failure to provide claim preparer information	99
71	163.3	Electronic suppression of sales – penalties	100
72	197	SIFT partnerships	101

Clause in Legislation	Section Amended	Topic	Page
73	204.81	Conditions for registration	102
74	207.01	Taxes in respect of certain registered plans	102
75	207.04	Tax payable on prohibited or non-qualified investment	112
76	207.05	Transitional prohibited investment benefit – filing rules	113
77	207.06	Waiver of taxes	114
78	207.061	TFSA income inclusion	114
79	207.07	Return and payment of tax	114
80	211.7	“labour-sponsored funds tax credit”	115
81	211.81	Tax for failure to reacquire certain shares	115
82	212.1	Non-arm’s length share sale by non-resident	116
83	214	Part XIII – non-resident withholding tax	116
84	219	Branch tax	117
85	239	Disclosure of information	117
86	239.1	Electronic suppression of sales – offences	118
87	241	Disclosure of information	119
88	247	Exclusion – certain guarantees	120
89	248	Definitions	120
90	249	Year-end on certain events	129
91	251.1	Affiliated persons	130
92	251.2	Loss restriction event	131
93	256	Acquiring control	136
94	256.1	Corporate tax-attribute trading	138
Keeping Canada’s Economy and Jobs Growing Act			
95	64	Swap transaction	142
Income Tax Regulations			
96	201	Investment income	143
97	306	Exempt policies	143
98	600	Elections	144
99	806.2	Prescribed obligation	144
100	1100	Capital cost allowance rates	144
101	1101	Separate classes – businesses and properties	150
102	1102	Special property rules	150
103	1104	Capital cost allowance – interpretation	152
104 & 105	Part XXX	Communication of information	154
106	Part XLVI	Investment tax credits	155
107 & 108	4900	Prescribed property	156
109	Part L	Excluded property	156
110	5204	Definitions	156

Clause in Legislation	Section Amended	Topic	Page
111	5600	Prescribed distributions	157
112	6500	Prescribed laws	157
113	6701.1	Prescribed labour-sponsored venture capital corporation	158
114	8200.1	Prescribed energy conservation property	158
115	8900	Prescribed international organizations	158
116 to 119	Schedule II	Capital cost allowance – prescribed classes	159
120		Coordinating amendment	161
		Part 2 – Amendments to the Excise Tax Act	
121	285.01	Electronic Suppression of Sales – Administrative Monetary Penalties	162
122	298	Period for Assessment	163
123	327.1	Electronic Suppression of Sales – Offences	164
124	V/VI/10	Supplies All or Substantially All for No Consideration	165

Part 1

Amendments to the Income Tax Act and the Income Tax Regulations

Income Tax Act

Clause 2

Valuation of inventory – loss restriction event

ITA
10

Section 10 of the *Income Tax Act* (the "Act") provides rules for the valuation of inventory for the purpose of computing a taxpayer's income or loss from a business.

ITA
10(10)

Subsection 10(1.01) of the Act values inventory that is part of a taxpayer's business that is an adventure or concern in the nature of trade at its original cost to the taxpayer. In effect, this type of inventory cannot be written down, and any accrued losses cannot be recognized, until its disposition. Subsection 10(10) sets out an exception to this general rule.

Subsection 10(10) provides that in the case of a corporation the control of which is acquired at any time, the corporation's inventory from a business that is an adventure or concern in the nature of trade is to be valued, at the end of a corporation's last taxation year (as determined by subsection 249(4)) before that time, at the lower of its original cost to the corporation and its fair market value at the end of that year. This allows the recognition of any accrued losses from that inventory in computing the corporation's income for that taxation year. Subsection 10(10) also provides that after the relevant acquisition of control, the corporation's cost of the property is that lower amount.

Subsection 10(10) is amended to extend its application to trusts. Specifically, the reference to control of a corporation being acquired is replaced with a reference to a taxpayer being subject to a loss restriction event. For further information, see the commentary on sections 251.2 and 256.

This amendment comes into force on March 21, 2013.

ITA
10(11)

Subsections 88(1.1) and 111(5) of the Act apply to restrict the carry over from one taxation year to another of certain unused non-capital or farm losses of a corporation if the corporation was subject to an intervening acquisition of control. An exception applies, allowing those losses to be carried over to be used in another year if, among other things, the relevant business is carried on for profit or with a reasonable expectation of profit throughout the other year.

For the purposes of subsections 88(1.1) and 111(5), subsection 10(11) deems a corporation's business that is at any time an adventure or concern in the nature of trade to be a business carried on at that time by the corporation.

Subsection 10(11) is amended to extend its application to trusts, consequential on an amendment to subsection 111(5) to extend that subsection to trusts. Amended subsection 111(5) applies to a taxpayer that is a corporation or trust when the taxpayer is subject to a loss restriction event.

This amendment comes into force on March 21, 2013.

Clause 3

Proprietor of business

ITA
11(1)

Subsection 11(1) of the Act provides that where an individual is a proprietor of a business, the individual's income from the business for a taxation year is the individual's income from the business for the fiscal periods of the business that end in the year. Subsection 11(1) is amended to delete the reference to former section 34.2, which concerns now repealed 10-year transitional relief rules in respect of changes to the definition "fiscal period".

This amendment applies to taxation years that end after March 22, 2011.

Clause 4

Income inclusions

ITA
12

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

Gain – derivative forward agreement

ITA
12(1)(*z.7*)

New paragraph 12(1)(*z.7*) of the Act requires the inclusion in computing a taxpayer's income of any profit from a derivative forward agreement, which is defined in subsection 248(1). Subparagraph 12(1)(*z.7*)(i) applies to purchases of capital property under a derivative forward agreement. It provides that, if a taxpayer acquires a property under a derivative forward agreement in a taxation year, an amount is required to be included in computing the taxpayer's income for the year equal to the amount by which the fair market value of the property at the time it is acquired by the taxpayer exceeds the cost to the taxpayer of the property.

Subparagraph 12(1)(*z.7*)(ii) applies to sales of capital property under a derivative forward agreement. It provides that, if a taxpayer disposes of a property under a derivative forward agreement in a taxation year, an amount is required to be included in computing the taxpayer's income for the year equal to the amount by which the proceeds of disposition (within the meaning assigned by subdivision c) of the property exceeds the fair market value of the property at the time the agreement is entered into.

A deduction is provided under paragraph 20(1)(*xx*) where the purchase or sale of a capital property under a derivative forward agreement results in a loss. An increase in the adjusted cost base of the capital property purchased or sold is provided under paragraphs 53(1)(*s*) and (*t*) where an amount is included in a taxpayer's income under paragraph 12(1)(*z.7*). Similarly, a decrease in the adjusted cost base of the capital property is provided under paragraphs 53(2)(*w*) and (*x*) where an amount is deductible under paragraph 20(1)(*xx*).

For further information, see the commentary on paragraphs 20(1)(*xx*), 53(1)(*s*) and (*t*) and 53(2)(*w*) and (*x*) and the definition "derivative forward agreement" in subsection 248(1).

Transitional Rules

Paragraph 12(1)(*z.7*) applies to acquisitions and dispositions of property that occur after March 20, 2013, unless transitional relief is available. Transitional relief is not available for acquisitions and dispositions of property that occur after March 21, 2018. The coming-into-force rules (i.e., the transitional rules) applicable to an acquisition or disposition of property under a derivative forward agreement depend upon whether the agreement was entered into before March 21, 2013 or after March 20, 2013.

Paragraph (3)(*a*) of the transitional rules applies to agreements entered into after March 20, 2013. Paragraph (3)(*b*) applies to agreements entered into before March 21, 2013. Agreements entered into after March 20, 2013 will only be eligible for transitional relief if they are part of a series of derivative forward agreements and a predecessor agreement was entered into before March 21, 2013. As a result, agreements entered into before March 21, 2013 can be extended or renewed to the end of 2014 without paragraph 12(1)(*z.7*) of the Act applying to acquisitions or dispositions under the agreement, provided certain conditions are met. For example, in order for an agreement to be renewed, the new agreement must be substantially similar to the prior agreement. This requirement is intended to ensure a measure of continuity. This requirement is not intended to prevent, for example, taxpayers from changing the counterparty to an agreement, the settlement date of an agreement or the composition of the underlying reference investments.

There are also restrictions relating to the size of the agreement. These size restrictions are intended to limit new investments in an existing derivative forward agreement. The term “notional amount” is used in respect of a derivative forward agreement in the transitional rules to describe the ‘size’ of the agreement at any particular time. More specifically, in respect of a purchase agreement, the notional amount of the agreement is the fair market value of the property that would be acquired under the agreement if the agreement were finally settled at that time. For sale agreements, the notional amount of the agreement is the sale price of the property that would be sold under the agreement if the agreement were finally settled at that time.

Transitional Rules Announced on March 21, 2013

The transitional relief provided in subparagraph (3)(*a*)(i) of the transitional rules reflects the coming-into-force rules that were announced on March 21, 2013. Where the more favourable transitional relief found in subparagraph (3)(*a*)(ii) is unavailable (e.g., because the agreement exceeded the size limits contained in the subparagraph), the transitional relief in subparagraph (3)(*a*)(i) may still be available. It provides transitional relief to an acquisition or disposition under a derivative forward agreement if that agreement is part of a series of agreements that includes both an agreement entered into before March 21, 2013 and an agreement entered into after March 20, 2013 and before July 11, 2013. In that case, agreements entered into before March 21, 2013 will not be taken into consideration in determining whether the series of agreements has a term in excess of 180 days. This would provide transitional relief for up to 180 days from the date the first agreement is entered into after March 20, 2013.

Source of income

ITA
12(2.02)

Economic Action Plan 2013 announced the extension of the thin capitalization rules to partnerships that operate in Canada and of which a Canadian-resident trust, or a non-resident corporation or trust, is

a member. New subsection 12(2.02) of the Act provides that any amount included in computing the income of a partner for a taxation year because of paragraph 12(1)(*l.1*) is deemed to have the same source as the income against which the relevant interest expense is deductible at the partnership level.

The subsection ensures that any income inclusion under paragraph 12(1)(*l.1*) for a non-resident partner will be taxable in Canada to the same extent as income earned through the partnership. For further information, please see the commentary on subsections 18(4) and 18(7).

This amendment applies to taxation years that begin after 2013.

Clause 5

Stapled securities – anti-avoidance

ITA
12.6

New section 12.6 of the Act provides a series of anti-avoidance rules that operate in conjunction with new section 18.3. Section 18.3 introduces a regime that applies to deny deductions for certain amounts that are paid or payable in respect of certain types of stapled securities. In general terms, a stapled security involves two or more separate securities that are “stapled” together such that the securities are not freely transferable independently of each other. Stapled securities allow deductions to be taken that frustrate the policy objectives of the tax on specified investment flow-through (SIFT) trusts and partnerships, and of the tax regime for real estate investment trusts (REITs). Stapled securities also have the potential to inappropriately erode the Canadian corporate tax base.

In order for an entity to avoid the application of section 18.3, it must unstaple its affected securities. However, it might be possible for stapled securities to be temporarily unstapled and later restapled. The effect of section 12.6 is to disregard any unstapling that is not carried out on a permanent and irrevocable basis.

Section 12.6 requires an entity to include in its income in a taxation year amounts that were deducted during a period of temporary unstapling of a particular security that would otherwise be a stapled security. If a stapled security of the entity that has been unstapled is restapled in the year then the entity must include in its income for the year all amounts that were deducted during the period of temporary unstapling and that would not, absent the unstapling, have been deductible by operation of section 18.3. The requirement to include an amount in income under section 12.6 also applies if the stapled security of the entity is a security that replaces another security of the entity, or that replaces another security of another entity, that was an unstapled stapled security of the entity or of the other entity (as the case may be). The tax on this income inclusion is also subject to interest as a late balance owing.

Section 12.6 is deemed to have come into force on July 20, 2011. For further information on stapled securities, see the commentary on section 18.3.

Definitions

ITA
12.6(1)

New subsection 12.6(1) of the Act provides that the definitions in section 18.3 apply for the purposes of section 12.6. For further information, see the commentary on section 18.3.

Where subsection (3) applies

ITA
12.6(2)

New subsection 12.6(2) of the Act sets out the circumstances in which an income inclusion rule, outlined in subsection 12.6(3), will apply if it is found that the provisions of section 18.3 have been circumvented by temporarily unstapling a stapled security. Subsection 12.6(2) provides that subsection 12.6(3) will apply for a taxation year of an entity in respect of a security of the entity if:

- at a particular time in the year, the security becomes a stapled security of the entity, resulting in certain amounts (generally interest paid or payable on a debt obligation that is a stapled security, or amounts, such as rent, paid or payable to an entity that is part of a stapled security structure that includes a real estate investment trust) ceasing to be deductible because of the application of subsection 18.3(3);
- prior to the particular time, the security (or any security for which it was substituted) ceased to be a stapled security of any entity, resulting in the deductibility of certain amounts (such as those described immediately above) no longer being denied under subsection 18.3(3); and
- throughout the period beginning immediately after the most recent time that the security (or any security for which it was substituted) ceased to be a stapled security of any entity and ending at the particular time, the security (or any security for which it was substituted) was not a stapled security of any entity.

Subsection 12.6(2) is part of an anti-avoidance rule that is intended to apply broadly to a temporary unstapling of a security. The subsection makes a distinction between a security of *an* entity becoming a stapled security of the entity (as described by paragraph 12.6(2)(*a*)) and a stapled security of *any* entity having ceased to be a stapled security of that entity (as described by paragraph 12.6(2)(*b*)). In this sense, the provision does not require that the same entity have issued a security that is "unstapled" and a security that is "restapled". If a predecessor entity issues at a given time a stapled security that is unstapled, and a different entity subsequently issues a newly-stapled security that is substituted for the original security, the arrangement will be captured by paragraphs 12.6(2)(*b*) and (*a*) respectively. If neither security was a stapled security from the time of unstapling to the time of restapling (and if no intervening security in a chain of substitutions was a stapled security during that time), then paragraph 12.6(2)(*c*), and therefore the income inclusion rule in subsection 12.6(3), will apply.

Although subsection 12.6(2) applies in circumstances that include a chain of substitutions involving potentially multiple entities, it also applies in circumstances involving a single entity. The entity that issues a security that is "unstapled" (as described by paragraph 12.6(2)(*b*)) and the entity that issues a security that is "restapled" (as described by paragraph 12.6(2)(*a*)) might be the same entity. If a single entity is involved in a temporary unstapling arrangement, the provisions will apply both where the entity unstaples a given security and issues a different newly-stapled security, and where the same security is unstapled and then restapled.

For further information, see the commentary on subsection 12.6(3).

Income inclusion

ITA
12.6(3)

Subsection 12.6(3) of the Act is introduced to require an income inclusion when the conditions in subsection 12.6(2) are satisfied. If subsection 12.6(3) applies for a taxation year of an entity in respect of a security of the entity, the entity is required to include in its income for that year each amount that was deducted by the entity (or by another entity that issued a security for which the security was substituted) in computing income for a taxation year that includes any part of the period of temporary unstapling described in paragraph 12.6(2)(*c*), and that would not have been deductible if subsection 18.3 applied in respect of the amounts.

This ensures that all amounts deducted during a period of unstapling (that subsequent events determined to be not permanent and irrevocable) of a security are brought into income in the year in which restapling of the security occurs, thereby, in effect, reversing the prior deductions. In addition, subsection 12.6(4) provides that interest is payable in respect of the tax on this income inclusion.

For further information, see the commentary on subsections 12.6(2) and (4).

Deemed excess

ITA
12.6(4)

Subsection 12.6(4) of the Act is introduced to charge interest in respect of an amount included in income under subsection 12.6(3). The amount will have been deducted by an entity during a period of temporary unstapling of a security, but ought not to have been deducted if a restapling of the security (or the creation of a new stapled security that is substituted for the originally-stapled security) means that the unstapling was not carried out on a permanent and irrevocable basis.

Although subsection 12.6(3) brings the amount into income in the year of restapling, when the provision applies, an entity is presumed to have benefitted from the earlier deduction during the period of unstapling. Accordingly, subsection 12.6(4) applies, for the purposes of subsection 161(1), to deem the entity that is subject to the income inclusion for a given year under subsection 12.6(3) to have an excess (*i.e.,* tax owing) immediately after its balance-due day for the year computed as if

- the entity were resident in Canada throughout the year;
- the tax payable by the entity for the year were equal to the tax payable by the entity on its taxable income for the year;
- the amount included in the entity's income under subsection 12.6(3) were the only taxable income of the entity for the year;
- the entity claimed no deductions under Division E for the year;
- the entity had not paid any amounts on account of its tax payable for the year; and
- the tax payable had been outstanding throughout the period that begins immediately after the end of the taxation year for which the amount was deducted and that ends on the entity's balance-due day for the year.

Although an income inclusion under subsection 12.6(3) may be in respect of numerous amounts deducted during a period of temporary unstapling, subsection 12.6(4) applies to each separate amount

deducted. As such, the excess in respect of each amount will be deemed to be outstanding only from the end of the taxation year for which the amount was deducted (as opposed to the end of the taxation year in which unstapling occurs).

For further information, see the commentary on subsections 12.6(2) and (3).

Clause 6

Depreciable property

ITA
13
Section 13 of the Act provides a number of rules related to the treatment of depreciable property. Generally, those rules apply for the purposes of sections 13 and 20 and the capital cost allowance regulations.

ITA
13(7)(*f*)

Subsection 13(7) of the Act contains rules relating to the capital cost of depreciable property. Paragraph 13(7)(*f*) applies to determine the capital cost to a corporation of a property if the property is disposed of, and reacquired, by the corporation under paragraph 111(4)(*e*) in the circumstances of an acquisition of control of the corporation. Paragraph 111(4)(*e*) allows a corporation that has been subject to an acquisition of control, to elect to dispose of certain capital properties, with the resulting recognition of income or gains accrued up to the time at which control was acquired. Property designated in the election is treated as having been reacquired by the corporation at the time control was acquired. For depreciable property, paragraph 13(7)(*f*) applies to assign the property on reacquisition a capital cost equal to the total of the capital cost to the corporation of the property at the time of the disposition and one-half of the excess of the proceeds of disposition of the property over such capital cost.

Paragraph 13(7)(*f*) is amended to extend its application to trusts, consequential on an amendment to subsection 111(4) to extend the application of that subsection to trusts. Amended subsection 111(4) applies to a taxpayer that is a corporation or trust when the taxpayer is subject to a loss restriction event. For further information, see the commentary on sections 111 and 251.2.

This amendment comes into force on March 21, 2013.

Ascertainment of certain property

ITA
13(18.1)

Subsection 13(18.1) of the Act provides that, in determining whether a particular property is prescribed energy conservation property, the *Technical Guide to Class 43.1* (published by the Department of Natural Resources and as amended from time to time) applies conclusively with respect to engineering and scientific matters. Section 8200.1 of the *Income Tax Regulations* provides that "prescribed energy conservation property" means property described in Class 43.1 or 43.2 in Schedule II to the *Income Tax Regulations*. Department of Natural Resources is expected to soon publish a new guide, whose title would reflect its application to both Classes 43.1 and 43.2 in Schedule II. Therefore, subsection 13(18.1) is amended to refer to the *Technical Guide to Class 43.1 and 43.2*.

This amendment applies on and after the day the *Technical Guide to Class 43.1 and 43.2* is first published by the Department of Natural Resources.

ITA
13(21.2)

Subsection 13(21.2) of the Act defers, in certain circumstances, the realization of a loss that would otherwise arise from the disposition by a person or partnership (the transferor) of a depreciable property. The subsection applies if the transferor or an affiliated person holds the disposed property, or has a right to acquire it, 30 days after the disposition. Until the earliest of certain so-called "release events" described in subparagraph 13(21.2)(*e*)(iii) occurs, the transferor is treated as holding a notional depreciable property the capital cost of which is, in effect, the amount of the deferred loss.

One such release event, described in clause 13(21.2)(*e*)(iii)(D), is the acquisition of control of a corporation. The corporation is treated as no longer holding notional depreciable property as of the time that is immediately before the time that is immediately before control is acquired. The result is that the suspended terminal loss is recognized by the corporation in its last taxation year (as determined by subsection 249(4)) before its acquisition of control.

Clause 13(21.2)(*e*)(iii)(D) is amended to extend its application to trusts, by referring to a transferor that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

ITA
13(24) and (25)

Subsection 13(24) applies if a corporation, or a partnership of which a corporation is a majority-interest partner, acquires a depreciable property (subject to an exception for property transferred among affiliated persons including the corporation or partnership) within the 12-month period that ends immediately before an acquisition of control of the corporation. If the property was not used, or acquired for use, in a business carried on by the corporation immediately before that period, two rules apply. First, if the property was disposed of and not reacquired before the acquisition of control, the property is treated for capital cost allowance purposes as having been acquired immediately before the disposition. If the first rule does not apply, for purposes of the investment tax credit rules in section 127, the refundable investment tax credit rules in sections 127.1 and the computation of undepreciated capital cost, the property is treated as not having been acquired until after the acquisition of control.

Subsection 13(24) is amended to extend its application to trusts. Specifically, the subsection applies if a taxpayer that is a corporation or trust, a partnership of which the taxpayer is a majority-interest partner or, after September 12, 2013, a trust of which the taxpayer is a majority-interest beneficiary (as defined in subsection 251.1(3)), acquires a depreciable property within the 12-month period that ends immediately before the taxpayer is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

If a taxpayer referred to in subsection 13(24) is formed shortly before it became subject to a loss restriction event, the exception provided in that subsection for transfers among affiliated persons will not apply. Specifically, the acquired property will not be able to meet the test of having been held by the taxpayer or by an affiliated person throughout the relevant period. Subsection 13(25) ensures the appropriate result under subsection 13(24) in such a case. Subsection 13(25) treats a newly-formed corporation or trust as having been in existence from the time immediately before the relevant 12-

month period to the time immediately after it was formed, and as having been affiliated during that time with the persons with whom it was affiliated from its formation until it is subject to a loss restriction event.

Subsection 13(25) is amended to extend its application to trusts, consequential on the extension of subsection 13(24) to trusts. The references in subsection 13(25) to “incorporated or otherwise formed” have been changed to “formed or created” to account for trusts.

These amendments come into force on March 21, 2013.

Clause 7

Eligible capital property

ITA
14
Section 14 of the Act provides rules concerning the tax treatment of expenditures and receipts of a taxpayer in respect of “eligible capital property”.

ITA
14(12)(*f*)

Subsection 14(12) of the Act applies if a corporation, trust or partnership (the transferor) disposes of eligible capital property in respect of a business and would, in the absence of the subsection, be entitled as a consequence of the disposition to claim a deduction under subsection 24(1) for any undeducted amounts remaining in its cumulative eligible capital pool in respect of the business. If the transferor or an affiliated person acquires the property (or an identical property) during the period that begins 30 days before the disposition and ends 30 days after the disposition and the transferor or an affiliated person owns the property at the end of that period, the transferor is treated as owning eligible capital property in respect of the business and not to have ceased carrying on the business until the earliest of certain so-called “release events” described in paragraphs 14(12)(*c*) to (*g*).

One such release event, as described in paragraph 14(12)(*f*), is, if the transferor is a corporation, the acquisition of control of the transferor. Paragraph 14(12)(*f*) is amended, to extend its application to trusts, by referring to a transferor that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

Clause 8

Prohibited deductions

ITA
18
Section 18 of the Act lists deductions that are prohibited in computing a taxpayer’s income from a business or property.

Limitation – deduction of interest by certain entities

ITA
18(4)

The thin capitalization rules in subsections 18(4) to 18(8) of the Act prevent a corporation resident in Canada from deducting interest on debts owing to certain specified non-residents to the extent that the

debts owing to such non-residents exceed a 1.5-to-1 debt-to-equity ratio. Economic Action Plan 2013 announced the extension of the scope of application of the thin capitalizations rules to Canadian-resident trusts and to non-resident corporations and trusts. Non-resident corporations and trusts that file a tax return under Part I of the Act in accordance with section 216 will be subject to the thin capitalization rules as they apply to non-residents.

Subsection 18(4) of the Act is amended to extend the scope of application of the thin capitalization rules to Canadian-resident trusts and to non-resident corporations and trusts that operate in Canada, whether directly or as members of a partnership. The thin capitalization rules do not apply to a Canadian banking business of an authorized foreign bank (these businesses are addressed in section 20.2).

Subsection 18(4) is also amended to replace the description of a corporation's equity for the purposes of the thin capitalization rules in clauses 18(4)(*a*)(ii)(A) to (C) with the new defined term "equity amount". This definition incorporates the current description of a corporation's equity for thin capitalization purposes along with defining the 'equity' of Canadian-resident trusts and non-resident corporations and trusts. For further information, please see the commentary on the definition of "equity amount" in subsection 18(5).

These amendments apply to taxation years that begin after 2013.

Definitions

ITA
18(5)

Subsection 18(5) of the Act is amended in two ways. First, the definition "outstanding debts to specified non-residents" is amended to reflect the extension of the thin capitalization rules to Canadian-resident trusts and to non-resident corporations and trusts. Second, the following definitions are introduced: "beneficiary", "equity amount", "equity contribution", "specified beneficiary", "specified non-resident beneficiary" and "tax-paid earnings".

"beneficiary"

Subsection 18(5) of the Act is amended to add the definition "beneficiary". For the purposes of the thin capitalization rules in subsections 18(4) to (6), a beneficiary of a trust has the same meaning as in subsection 108(1).

This amendment applies to taxation years that begin after 2013.

"equity amount"

Subsection 18(5) of the Act is amended to add the definition "equity amount". Paragraph (*a*) of the definition contains the description of a Canadian-resident corporation's equity previously found in clauses 18(4)(*a*)(ii)(A) to (C). Paragraph (*b*) contains the description of a Canadian-resident trust's 'equity' and paragraph (*c*) contains a description of a non-resident corporation or trust's 'equity' for thin capitalization purposes.

Paragraph (b) of the definition "equity amount" – Trusts resident in Canada

The equity amount of a trust, resident in Canada, for a taxation year is computed by determining the amount by which the total of:

- the average amount of all equity contributions made by specified non-resident beneficiaries to the trust before the beginning of each month in the year, and
- the tax-paid earnings of the trust for the year,

exceeds

- the average amount of all distributions made the trust to its specified non-resident beneficiaries before the beginning of each month in the year (except if such amounts are included in the beneficiary's income because of subsection 104(13) or from which tax was deducted under Part XIII because of paragraph 212(1)(*c*)).

As with the rules for Canadian-resident corporations in paragraph (*a*) of the definition, this computation effectively provides that a Canadian-resident trust's equity amount is determined by reference to the capital contributions from specified non-residents less returns of capital to specified non-residents plus retained earnings.

An election is available for a trust to compute its equity as at March 21, 2013 based on the amount of its assets less the amount of its liabilities. Although this election is available to all Canadian-resident trusts, it is intended to assist trusts that have insufficient historical information available to determine their equity amounts on March 21, 2013. A trust must elect in writing and file the election with the Minister of National Revenue on or before its filing-due date for its first taxation year that begins after 2013.

If the election is made, for the purpose of determining the trust's equity amount, the trust is deemed: not to have received any equity contributions (as defined in subsection 18(5)) before March 21, 2013; not to have paid or made payable any amount to a beneficiary of the trust before March 21, 2013; and to have tax-paid earnings (as defined in subsection 18(5)) of nil for each taxation year that ends before March 21, 2013.

As well, the election determines the trust's equity amount based on the value of its assets less the amounts of its liabilities on March 21, 2013. Each beneficiary of the trust at the start of March 21, 2013 is deemed to have made an equity contribution at that time to the trust equal to the amount determined by the formula: A/B x (C – D). A/B provides the beneficiary's proportionate interest in the trust, based on the relative fair market value of the beneficiary's interest in the trust. Variable C is the fair market value of all the properties of the trust at the start of March 21, 2013 and variable D is the total amount of the trust's liabilities at that time.

Paragraph (c) of the definition "equity amount" – Corporations and trusts not resident in Canada

Since a Canadian branch of a non-resident corporation or trust is not a separate legal person from the non-resident entity, it does not have equity as determined for thin capitalization purposes. Therefore, a 3-to-5 (or 60%) debt-to-assets ratio is used to provide a notional amount of equity against which the debts of the non-resident entity are tested, which parallels the 1.5-to-1 debt-to-equity ratio used for Canadian-resident corporations. The debt-to-assets ratio is based on the cost of the assets used or held by the non-resident entity in respect of its Canadian activities.

Based on the 3-to-5 debt-to-assets ratio, the permitted equity amount threshold for a non-resident corporation or trust, for thin capitalization purposes, is generally computed as being 40% of the cost, on an averaged basis, of the assets or property used or held by the non-resident corporation or trust in respect of its Canadian activities less the outstanding debts of the non-resident entity that relate to its Canadian activities and that are not included in its outstanding debts to specified non-residents.

This amendment applies to taxation years that begin after 2013.

Example – Canadian branch of a non-resident corporation

NRFinco and NROpco are wholly-owned subsidiaries of NRParent, all of which are corporations and none of which are resident in Canada. NROpco carries on a business in Canada through a branch. The properties of NROpco used in its Canadian branch have a total cost of $350,000. NRFinco has made a loan of $150,000 to NROpco, the proceeds of which are used by NROpco in its Canadian business. An arm's length financial institution has made a loan of $100,000 to NROpco, the proceeds of which are also used by NROpco in its Canadian business.

NROpco's equity amount would equal 40% of the amount, if any, by which the total cost of the Canadian branch's assets ($350,000) exceeds the amount of its debts used in the Canadian branch that are not owing to specified non-residents ($100,000). This is multiplied by 1.5 to arrive at NROpco's thin capitalization limit. The limit is 1.5 x 40% ($350,000 - $100,000) = $150,000. NROpco would therefore be entitled to deduct interest on up to $150,000 of non-arm's length debts. This corresponds to a 3-to-5 (or 60%) debt-to-assets ratio.

"equity contribution"

Subsection 18(5) of the Act is amended to add the definition "equity contribution". An equity contribution to a trust is a transfer of property to the trust made in exchange for an interest as a beneficiary under the trust, or a right to acquire such an interest, or for no consideration by a person beneficially interested in the trust.

This amendment applies to taxation years that begin after 2013.

"outstanding debts to specified non-residents"

The application of the thin capitalization rules to a debt depends on whether the debt is included in a taxpayer's "outstanding debts to specified non-residents". Paragraph (*a*) of the definition "outstanding debts to specified non-residents" is amended to extend the current definition to address debts of a trust by adding references to trusts and to a specified non-resident beneficiary of a trust. Specified non-resident beneficiary is defined in subsection 18(5).

This amendment applies to taxation years that begin after 2013.

"specified beneficiary"

Subsection 18(5) of the Act is amended to add the definition "specified beneficiary". This definition is based on the existing "specified shareholder" definition in subsection 18(5). It provides that a person (either alone or together with persons with whom that person does not deal at arm's length) who owns 25% or more of the fair market value of all interests as a beneficiary under a trust is a specified beneficiary of that trust.

For the purpose of determining whether a particular person has met the 25% threshold, that person's rights (and those of non-arm's length persons) to acquire beneficial interests are deemed to have been exercised. Any beneficial interests, other than beneficial interests held by the person, that the person (or a non-arm's length person) has the right to require a trust to redeem, acquire or terminate will be considered to have been so redeemed, acquired or terminated. This does not apply if the exercise of the right is contingent on the death, bankruptcy or permanent disability of an individual. Where a

particular person has a discretionary interest in a trust, the person's maximum possible interest in the trust will be used in determining whether the 25% threshold has been met.

This amendment applies to taxation years that begin after 2013.

"specified non-resident beneficiary"

Subsection 18(5) of the Act is amended to add the definition "specified non-resident beneficiary". This definition is the corollary of the existing definition "specified non-resident shareholder" in subsection 18(5), which applies in the corporate context.

This amendment applies to taxation years that begin after 2013.

"tax-paid earnings"

Subsection 18(5) of the Act is amended to add the definition "tax-paid earnings". The determination of a Canadian-resident trust's equity amount (defined in subsection 18(5)) requires the computation of the tax-paid earnings of the trust for each of its taxation years. The tax-paid earnings of a trust resident in Canada for a taxation year are its taxable income under Part I of the Act for that year less the combined federal and provincial tax paid on that income for the particular year.

This amendment applies to taxation years that begin after 2013.

Specified shareholder or specified beneficiary

ITA
18(5.1)

Subsection 18(5.1) of the Act ensures that a person who would otherwise be a specified shareholder of a corporation will not be treated as such if the person becomes a specified shareholder in order to safeguard the person's rights in respect of indebtedness outstanding and owing to the person or a non-arm's length person, and it is reasonable to conclude that a condition or event contemplated in an agreement in effect at the time the provision is being applied will occur to cause the person no longer to be a specified shareholder.

Subsection 18(5.1) is amended to extend the current rule to apply in the trust context by adding references to a specified beneficiary of a trust (specified beneficiary is defined in subsection 18(5)).

This amendment applies to taxation years that begin after 2013.

Deemed specified shareholder or specified beneficiary

ITA
18(5.2)

Economic Action Plan 2013 announced the extension of the thin capitalization rules to non-resident corporations and trusts that carry on business in Canada, or that, in accordance with section 216 of the Act, are taxable in Canada under Part I (rather than Part XIII) of the Act on certain income. The Canadian operations of these non-resident corporations and trusts are effectively treated in the same way as if they were carried out through a wholly-owned subsidiary. However, a Canadian branch is not a separate legal person from the non-resident corporation or trust that it is a part of and as a consequence, a Canadian branch does not have specified shareholders and a non-resident cannot make a loan directly to it.

Therefore, for the purpose of applying the thin capitalization rules to non-resident corporations and trusts, new subsection 18(5.2) is added to deem a non-resident corporation to be a specified

shareholder of itself and a non-resident trust to be a specified beneficiary of itself. The effect of this deeming rule and clause (*a*)(i)(B) of the definition "outstanding debts to specified non-residents" in subsection 18(5) is that a loan to a non-resident corporation or trust from a non-resident person who does not deal at arm's length with the non-resident corporation or trust will be included in outstanding debts to specified non-residents for the non-resident corporation or trust. This result is consistent with that where a loan is made to a Canadian subsidiary from a non-resident person that does not deal at arm's length with the foreign parent of the Canadian subsidiary.

This amendment applies to taxation years that begin after 2013.

Property used in business – cost attribution

ITA
18(5.3)

Economic Action Plan 2013 announced the extension of the thin capitalization rules to non-resident corporations and trusts that operate in Canada, whether directly or as members of a partnership. Non-resident corporations and trusts that operate in Canada through a branch are effectively treated in the same way as if the Canadian branch were a wholly-owned subsidiary of the non-resident. Since a branch does not have equity in the same sense as a wholly-owned subsidiary, a 3-to-5 debt-to-assets ratio is used for Canadian branches for thin capitalization purposes. The asset portion of this debt-to-assets ratio uses the cost of the property used or held by the non-resident entity in respect of its Canadian activities. As well, amended paragraph 18(7)(*a*) of the Act allocates to a non-resident partner its share of the property of the partnership, which is included with the non-resident's properties for the purpose of determining the non-resident's equity amount (as defined in subsection 18(5)). For further information, please see the commentary on subsections 18(4), (5) and (7).

Subsection 18(5.3) is introduced to provide rules that determine, in certain circumstances and for the purpose of determining the non-resident's equity amount, what the cost and use of a particular property is in relation to the Canadian activities of a non-resident corporation or trust. Paragraph 18(5.3)(*a*) provides a deeming rule that determines the cost of a property for thin capitalization purposes if the property is only partly used in Canada. This cost is based on the proportionate use of property in Canada compared to its total use. Subparagraphs 18(5.3)(*b*)(i) and (ii) deal with partnerships. They allow the thin capitalization rules to apply in respect of property held by a partnership in which a non-resident corporation or trust is a member in the same way the rules would apply if the partner's share of the property were held directly. Subparagraph 18(5.3)(*b*)(i) allocates the cost of properties of a partnership to its partners in the same proportion as the debts of the partnership are allocated. Subparagraph 18(5.3)(*b*)(ii) deems the property to be used or held by the partner in the course of carrying on business in Canada if the partnership used or held it in the course of carrying on business in Canada.

This amendment applies to taxation years that begin after 2013.

Rules – trust income

ITA
18(5.4)

In general terms, income earned by a trust can either be taxed in the trust or be paid or made payable to beneficiaries of the trust, in which case the trust is provided with a deduction and the income is taxable to the beneficiaries. Subsection 18(5.4) of the Act is introduced to allow the same results with respect to the additional income of a trust that arises as a consequence of the application of the thin

capitalization rules, whether due to the denial of interest expense under subsection 18(4) or an income inclusion under paragraph 12(1)(*l.1*).

Under subsection 18(5.4), a trust may elect that all or a portion of an amount that is paid or credited as interest by the trust, or a partnership in which the trust is a member, to a non-resident person be deemed to be income of the trust that has been paid to the non-resident person as a beneficiary of the trust. This election is available if the amount is not deductible in computing the trust's income because of subsection 18(4) or is included in computing the income of the trust under paragraph 12(1)(*l.1*). The amount would consequently be subject to non-resident withholding tax under Part XIII of the Act (and potentially to tax under Part XII.2).

This amendment applies to taxation years that begin after 2013.

Loan made on condition

ITA
18(6)

Subsection 18(6) of the Act is designed to ensure that the disallowance of interest expense under subsection 18(4) cannot be circumvented by a lending arrangement in which a specified non-resident shareholder of a corporation, instead of making a loan directly, makes it through an intermediary – for example, by lending funds to another person on condition that the other person make a loan to the corporation.

Subsection 18(6) is amended to extend the application of the provision to the trust context by adding references to a specified non-resident beneficiary (as defined in subsection 18(5)) of a trust. Specified non-resident beneficiary is the corollary of specified non-resident shareholder, which applies in the corporate context and is also defined in subsection 18(5).

This amendment applies to taxation years that begin after 2013.

Partnership debts

ITA
18(7)

Subsection 18(7) of the Act provides that, for the purposes of the thin capitalization rules, a partner's share of the debts of a partnership is included with the partner's directly owed debts in determining whether it has exceeded the debt-to-equity threshold under the thin capitalization rules.

The equity component of a non-resident corporation or trust's debt-to-equity ratio for thin capitalization purposes is determined in the new definition "equity amount" in subsection 18(5). A non-resident's equity amount is based in part on the non-resident's cost of its property that is used or held in its Canadian activities.

Paragraph 18(7)(*a*) is amended to allocate to a non-resident partner its share of the property (in addition to allocating its share of the debts) of the partnership for purposes of determining the partner's equity amount. More specifically, each member of a partnership is deemed to own a portion of each property of the partnership based on the partner's proportionate interest in the partnership.

This amendment applies to taxation years that begin after 2013.

ITA
18(15)(*b*)(iii)

Subsections 18(13) to (15) of the Act contain a loss suspension rule that applies to property disposed of by a taxpayer (the transferor) that is a money lender. Subsections 18(13) and (14), respectively, set out the conditions under which the relevant losses are suspended. Subsection 18(15) describes the loss suspension itself. The relevant loss is suspended until the earliest of certain so-called "release events" described in subparagraphs 18(15)(*b*)(i) to (iv). One such release event, described in subparagraph 18(15)(*b*)(iii), is, if the transferor is a corporation, the acquisition of control of the transferor.

Subparagraph 18(15)(*b*)(iii) is amended to extend its application to trusts, by referring to a transferor that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

Clause 9

Matchable expenditure

ITA
18.1

Section 18.1 of the Act restricts the deductibility of an otherwise deductible "matchable expenditure" incurred in respect of a "right to receive production" by prorating the deductibility of the amount of the expenditure over the economic life of the right.

ITA
18.1(10)(*b*)(ii)

Subsection 18.1(7) of the Act allows taxpayers to claim a terminal deduction upon the disposition or expiry of the right to which a matchable expenditure relates. Subsection 18.1(7) is, however, subject to the rules in subsections 18.1(8) to (10), which apply to a disposition or expiry of such a right where within a certain period of time an affiliated or non-arm's length person holds the property or identical property. In these circumstances, the terminal deduction is restricted until the earliest of certain so-called "release events" described in subparagraphs 18.1(10)(*b*)(i) to (v). One such release event, described in subparagraph 18.1(10)(*b*)(ii), is, if the taxpayer is a corporation, the acquisition of control of the taxpayer.

Subparagraph 18.1(10)(*b*)(ii) is amended to extend its application to trusts, by referring to a taxpayer that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

Clause 10

Stapled securities

ITA
18.3

New section 18.3 of the Act introduces a set of rules that apply to stapled securities. In general terms, a stapled security involves two or more separate securities that are "stapled" together such that the securities are not freely transferable independently of each other. Within the scope of section 18.3, a

stapled security is a publicly-traded security that is traded together with another security in circumstances that allow deductions to be taken that frustrate the policy objectives of the tax on specified investment flow-through (SIFT) trusts and partnerships, and of the tax regime for real estate investment trusts (REITs). These stapled securities also have the potential to inappropriately erode the Canadian corporate tax base.

Section 18.3 introduces a set of provisions that define a “stapled security”, deny the deduction of certain amounts (generally interest paid or payable on a debt obligation that is a stapled security, or rent paid or payable to an entity that is part of a stapled security structure that includes a REIT), and provide a transition period to defer the application of the deduction denial rule in certain circumstances.

Section 18.3 is deemed to have come into force on July 20, 2011. See the commentary on section 12.6 for a discussion of a related rule that may require an income inclusion in certain circumstances.

Definitions

ITA
18.3(1)

New subsection 18.3(1) of the Act defines a number of expressions that apply for the purposes of section 18.3. Some of these expressions are newly defined, while others have the same meaning for the purposes of section 18.3 as in section 122.1.

“entity”

The definition “entity” has the same meaning for the purposes of section 18.3 as it does for section 122.1 purposes: namely, a corporation, trust or partnership.

“equity value”

The definition “equity value” has the same meaning for the purposes of section 18.3 as it does for section 122.1 purposes: namely, the equity value of an entity at any time is the total fair market value of all of the issued and outstanding shares of a corporation, of all of the income and capital interests in a trust, or of all of the interests in a partnership.

“real estate investment trust”

The definition “real estate investment trust” has the same meaning for the purposes of section 18.3 as it does for section 122.1 purposes: namely, a trust is a real estate investment trust (REIT) for a taxation year if its beneficial interests are publicly traded, it is resident in Canada throughout the year and it meets a number of other conditions related to its property holdings and revenues.

“security”

The definition “security” for the purposes of section 18.3 does not have the same meaning as it does in section 122.1. For the purposes of section 18.3, a security of an entity means a liability of the entity, a share of the capital stock of a corporation, an income or a capital interest in a trust, and an interest as a member of a partnership. For these purposes, a security also means a right to control in any manner whatever the voting rights of a share of the capital stock of a corporation if it can be reasonably be concluded that one of the reasons that a person or partnership holds the right to control is to avoid the application of subsection 18.3(3) or 12.6(3).

Not included in the definition is a right to, or to acquire, anything described immediately above. As a result, a simple right to acquire equity contained in a security such as a convertible debenture, or innovative regulatory capital of a financial institution, is generally not intended to be a security for the purposes of section 18.3.

For further information, see the commentary on the definition “stapled security” in subsection 18.3(1), and the commentary on subsections 18.3(3) and 12.6(3).

“stapled security”

The definition “stapled security” is added to identify securities that are subject to the rule in subsection 18.3(3) that would deny a deduction in respect of certain amounts that are paid or payable in respect of a stapled security. In general terms, a stapled security involves two or more separate securities that are “stapled” together such that the securities are not freely transferable independently of each other.

Paragraph (*a*) of the definition sets out the requirement that a stapled security of a particular entity be “stapled” to another security (referred to in the definition as a “reference security”) such that the two securities, as a matter of ordinary commercial practice, trade together. This ordinary commercial practice is evidenced by the fact that the stapled security and the reference security will either be

- required to be transferred together or concurrently as a term or condition of the stapled security, the reference security or an agreement or arrangement to which the entity or the entity issuing the reference security is a party; or
- listed or traded together on a stock exchange or other public market under a single trading symbol.

Each security in a stapled security arrangement will be both a stapled security and a reference security in respect of each security to which it is stapled. For example, if a share of a corporation is stapled to a liability of the same corporation, the share will be a stapled security and the debt will be its reference security, which meets the conditions in paragraph (*a*) of the definition in respect of the share. Likewise, the debt will be a stapled security because the share is its reference security, which meets the conditions in paragraph (*a*) of the definition in respect of the debt.

Paragraph (*b*) of the definition sets out the requirement that a stapled security be publicly traded or listed.

Paragraph (*c*) of the definition sets out the requirement that a stapled security be issued by an entity that, together with the issuer of the reference security, exists as part of a stapled security arrangement. To this end, one of the following criteria must apply:

- the stapled security and the reference security are issued by the same entity, and the entity is a corporation, SIFT partnership or SIFT trust;
- the reference security and the stapled security are issued by two separate entities that exist in a parent-subsidiary relationship, and one of the entities is a corporation, SIFT partnership or SIFT trust; or
- the reference security and the stapled security are issued by two separate entities, and one of the entities is a REIT or a subsidiary of a REIT.

In a typical stapled security arrangement involving a public corporation, a share of the corporation is stapled to debt of the corporation or of a subsidiary of the corporation. In this type of arrangement,

subparagraph 18.3(3)(*b*)(i) would deny a deduction in respect of any amount that is paid or payable as interest on a liability that is part of a stapled security arrangement.

In a typical stapled security arrangement involving a REIT, an equity interest in the REIT (or a subsidiary of the REIT) is stapled to an equity interest in a taxable entity (or a subsidiary of the taxable entity). The taxable entity (or its subsidiary) carries on a business that the REIT could not carry on directly without losing its status as a REIT and in carrying on that business, the taxable entity leases property from the REIT. In this type of arrangement, subparagraph 18.3(3)(*b*)(ii) would deny a deduction in respect of payments, such as rent or interest, made by the taxable entity (or its subsidiary) to the REIT (or its subsidiary).

For further information, see the commentary on the definition "subsidiary" in subsection 18.3(1) and on subsection 18.3(3).

"subsidiary"

The definition "subsidiary" is added to clarify certain relationships between entities. A subsidiary of a particular entity at any time means an entity in which the particular entity holds securities that have a total fair market value that is greater than 10% of the equity value of the entity at that time. In addition, a subsidiary of a particular entity includes any entity that is a subsidiary of an entity that is a subsidiary of the particular entity. For example, if Corporation A holds shares of Corporation B that have a fair market value equal to 15% of the fair market value of all Corporation B shares, and if Corporation B in turn holds shares of Corporation C that have a fair market value equal to 15% of the fair market value of all Corporation C shares, then Corporation B is a subsidiary of Corporation A and Corporation C is a subsidiary of both Corporation B and Corporation A.

"transition period"

The definition "transition period" is added to specify which entities are subject to a delayed application of the rule in subsection 18.3(3) and when the rule will come into effect for those entities.

An entity has a transition period if securities of the entity that were issued and outstanding on July 19, 2011 would have been stapled securities on that date if the definition "stapled security" had been in force before that date. The definition "transition period" sets out three different cases in which an entity will have a transition period.

In the first case, described by paragraph (*a*) of the definition, an entity will have a transition period if securities of the entity would have been stapled securities of the entity on October 31, 2006 and on July 19, 2011. In the second case, described by paragraph (*b*) of the definition, an entity will have a transition period if paragraph (*a*) of the definition does not apply, and securities of the entity would have been stapled securities of the entity on July 19, 2011. In the third case, described by paragraph (*c*) of the definition, an entity will have a transition period if paragraphs (*a*) and (*b*) of the definition do not apply, and on July 20, 2011, the entity is a subsidiary of another entity (the "parent entity") that has a transition period.

In the case of paragraph (*a*) of the definition, the transition period of the entity ends on the earliest of January 1, 2016 and the first day after July 20, 2011 on which certain specified events (described below) occur. In the case of paragraph (*b*) of the definition, the transition period of the entity ends on the earliest of July 20, 2012 and the first day after July 20, 2011 on which those same specified events occur. In the case of paragraph (*c*) of the definition, the transition period of the subsidiary ends on the earliest of:

- the day on which the parent entity's transition period ends;
- the first day after July 20, 2011 on which the subsidiary ceases to be a subsidiary of the parent entity; and
- the first day after July 20, 2011 on which any security of the subsidiary becomes a stapled security of the subsidiary, other than by way of a transaction or issuance described in the two bullets immediately below.

The specified events referred to above are when a security is materially altered, or when any security of the entity becomes a stapled security of the entity other than by way of:

- a transaction completed under the terms of an arrangement in writing entered into before July 20, 2011 where no party to the agreement may be excused from completing the transaction as a result of amendments to the Act, and that is not the issuance of a security in satisfaction of a right to enforce payment of an amount by the entity; or
- the issuance of the security in satisfaction of a right to enforce payment of an amount payable by the entity on another security of the entity before July 20, 2011, if the other security was a stapled security on July 20, 2011 and the issuance was made under a term or condition of the other security in effect on July 20, 2011.

The first of these criteria generally describes transactions that are legally binding and that cannot be unwound or avoided as a result of changes to the Act. For example, the conversion or exchange of a particular security into a stapled security of the entity pursuant to a right of the holder of the particular security obtained by virtue of holding the particular security would amount to such a transaction, as long as no payment of any kind is made by the issuance of a stapled security. The second of these criteria generally describes the issuance of stapled securities pursuant to a dividend or distribution reinvestment plan (DRIP), as long as the distribution (by which the stapled security was issued) under the DRIP was declared before July 20, 2011, and cannot be suspended.

For further information, see the commentary on subsection 18.3(3).

Property representing a security

ITA
18.3(2)

Subsection 18.3(2) of the Act applies for the purposes of determining whether a particular security of an entity is a stapled security. It provides that if all or a portion of the particular security is represented by a receipt or similar property (the "receipt"), and the receipt would be described in paragraphs (*a*) and (*b*) of the definition "stapled security" in subsection 18.3(1) if it were a security of the entity, then the particular security is deemed to be described in those paragraphs, and a security that would be a reference security in respect of the receipt is deemed to be a reference security in respect of the particular security. This rule ensures, among other things, that liabilities that are issued by a particular entity as part of a stapled security arrangement and that are represented by receipts that trade together with securities of the entity (or of an entity that is in a parent-subsidiary relationship with the particular entity) – but that are not themselves described by paragraph (*a*) of the definition "stapled security" – will be subject to the rule in subsection 18.3(3).

For further information, see the commentary on the definition "stapled security" in subsection 18.3(1) and on subsection 18.3(3).

Amounts not deductible

ITA
18.3(3)

Subsection 18.3(3) of the Act is added to deny – notwithstanding the general rules applicable to the deductibility of amounts in computing a taxpayer's income – deductions in respect of certain amounts that are paid or payable by an entity. Subsection 18.3(3) applies, by operation of paragraph 18.3(3)(*a*), to amounts paid or payable after July 19, 2011, unless the amounts are paid or payable in respect of the entity's transition period.

Paragraph 18.3(3)(*b*) describes the kinds of amounts that are subject to the rule. Subparagraph 18.3(3)(*b*)(i) denies a deduction in respect of any amount that is paid or payable as interest on a liability of a particular entity that is a stapled security, unless each reference security in respect of the stapled security is a liability. Therefore, interest payable on a liability that is stapled to an equity interest would not, by operation of section 18.3, be deductible, but section 18.3 does not apply to prevent the deductibility of interest payable on a liability that is stapled only to another liability.

Subparagraph 18.3(3)(*b*)(ii) denies deductions in respect of amounts paid or payable between entities that are a part of a stapled security arrangement involving a REIT. Two criteria must be satisfied in order for a deduction to be denied to a particular entity under this subparagraph. Firstly, a security of the particular entity, a subsidiary of the particular entity or an entity of which the particular entity is a subsidiary must be a reference security in respect of a stapled security of a REIT or a subsidiary of a REIT. Secondly, the amount must be paid or payable to one of the following:

- the REIT;
- a subsidiary of the REIT; or
- any person or partnership on condition that any person or partnership pays or makes payable an amount to the REIT or a subsidiary of the REIT.

For further information, see the commentary on the definition "stapled security" in subsection 18.3(1).

Clause 11

Deductions

ITA
20

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

Premiums on life insurance used as collateral

ITA
20(1)(*e.2*)

Paragraph 20(1)(*e.2*) of the Act permits a limited deduction in respect of life insurance premiums under a life insurance policy where an interest in the policy has been assigned as collateral for a loan and certain other conditions are met. The amount deductible by a taxpayer may not exceed a specified portion of the lesser of the premiums payable by the taxpayer under the policy in respect of the year and the net cost of pure insurance (as determined in accordance with section 308 of the *Income Tax Regulations*) in respect of the interest in the policy for the same year. The specified portion is the

portion of the lesser of the two amounts that can reasonably be considered to relate to the amount owing from time to time during the year by the taxpayer under the loan.

Paragraph 20(1)(*e.2*) is amended so that amounts are not deductible under paragraph 20(1)(*e.2*) in respect of an LIA policy. Specifically, the preamble of paragraph 20(1)(*e.2*) is amended so that no amount is deductible in respect of a LIA policy or an annuity contract. For further information on LIA policies, see the commentary on the definition “LIA policy” in subsection 248(1).

Paragraph 20(1)(*e.2*) is also amended so that no amount will be deductible in respect of a 10/8 policy under that paragraph in respect of a period after 2013. In particular, the amount determined under amended subparagraph 20(1)(*e.2*)(ii) in respect of a 10/8 policy ignores, in computing the net cost of pure insurance for the relevant year in respect of the policy, the portion of that net cost in respect of insurance provided during a period after 2013 during which the policy is a 10/8 policy. For further information on 10/8 policies, see the commentary on the definition “10/8 policy” in subsection 248(1).

Finally, paragraph 20(1)(*e.2*) is restructured by moving the existing postamble of the paragraph into a new subparagraph 20(1)(*e.2*)(iii).

These amendments apply to taxation years that end after March 20, 2013.

Loss – derivative forward agreement

ITA
20(1)(*xx*)

New paragraph 20(1)(*xx*) of the Act provides a deduction in computing a taxpayer’s income of a loss from a derivative forward agreement, which is defined in subsection 248(1). The amount of the deduction that is available in a particular year is determined by the formula A – B.

Variable A is the lesser of subparagraphs (i) and (ii). Subparagraph (i) represents the accumulated losses under the derivative forward agreement. Subparagraph (ii) limits deductions in respect of partial (i.e., not final) settlements of a derivative forward agreement to the amount of income that has been included in respect of the agreement.

Subparagraph (i) of variable A provides the cumulative total of losses under the agreement. Clause (i)(A) applies to purchases and clause (i)(B) applies to sales. For clause (i)(A), the amount is determined as the amount by which the cost to the taxpayer of the property exceeds the fair market value of the property at the time it is acquired by the taxpayer. For clause (i)(B), the amount is determined as the amount by which the fair market value of the property at the time the agreement is entered into exceeds the proceeds of disposition (within the meaning assigned by subdivision c) of the property.

Subparagraph (ii) of variable A generally provides that, until final settlement of a derivative forward agreement occurs, the total amount of deductions available in respect of the derivative forward agreement is limited to the total of all amounts included under paragraph 12(1)(*z.7*) in computing the taxpayer’s income in respect of the derivative forward agreement. On final settlement of the agreement, the limitation continues to apply if one of the main reasons for entering into the agreement is to obtain a deduction under paragraph 20(1)(*xx*). This provision allows deductions where a loss arises as the consequence of a negative return on a *bona fide* investment and prevents the use of schemes designed, even in part, to obtain the benefit of the deduction.

Variable B of the formula in paragraph 20(1)(*xx*) ensures that amounts are deductible only once under paragraph 20(1)(*xx*).

A decrease in the adjusted cost base of the capital property purchased or sold is provided in paragraphs 53(2)(*w*) and (*x*) where an amount is deductible under paragraph 20(1)(*xx*). Similarly, an increase in the adjusted cost base of the capital property is provided in paragraphs 53(1)(*s*) and (*t*) where an amount is included in a taxpayer's income because of paragraph 12(1)(*z.7*).

For further information, see the commentary on paragraphs 12(1)(*z.7*), 53(1)(*s*) and (*t*) and 53(2)(*w*) and (*x*) and the definition "derivative forward agreement" in subsection 248(1).

Paragraph 20(1)(*xx*) applies to acquisitions and dispositions of property that occur after March 20, 2013, unless transitional relief is available. For further information, see the commentary on paragraph 12(1)(*z.7*).

Limitation of expression "interest" – 10/8 policy

ITA
20(2.01)

New subsection 20(2.01) of the Act has the effect of denying an interest deduction under paragraphs 20(1)(*c*) and (*d*) in respect of amounts paid or payable under a borrowing or policy loan that relates to a 10/8 policy (i.e., amounts described in paragraph (*a*) of the definition "10/8 policy" in subsection 248(1) in respect of a 10/8 policy).

An amount paid or payable under such a borrowing or policy loan is deemed not to be interest in two cases. The first case is if the amount is paid at a time after March 20, 2013 and in respect of a period after 2013, and at the time of the payment the policy is a 10/8 policy. The second case is if the amount is payable at a time after March 20, 2013 and in respect of a period after 2013 during which a policy is a 10/8 policy.

For further information on 10/8 policies, see the commentary on the definition "10/8 policy" in subsection 248(1).

This amendment applies to taxation years that end after March 20, 2013.

No deduction in respect of property in certain circumstances

ITA
20(8)(*d*)

Subsection 20(8) of the Act provides a limitation to the reserve allowed under paragraph 20(1)(*n*) in respect of the taxpayer's profit from the sale of certain property, where all or part of the proceeds of the sale are not due until at least two years after the time of sale. Paragraph 20(8)(*d*) disallows the reserve under paragraph 20(1)(*n*) where the purchaser of the property is a corporation controlled by the taxpayer or is a partnership of which the taxpayer is a majority interest partner.

The reference in the English version of paragraph 20(8)(*d*) to the term "majority interest partner" is replaced with a reference to "majority-interest partner". This amendment is consequential on a similar amendment to the definition "majority-interest partner" in subsection 248(1). For further information, see the commentary on that definition.

This amendment comes into force on Royal Assent.

Clause 12

Private health services plan

ITA
20.01

Section 20.01 of the Act permits an individual to deduct, in computing the individual's income from a business carried on by the individual and in which the individual is actively engaged on a regular and continuous basis (directly or as a member of a partnership), amounts payable under a private health services plan (PHSP) for the benefit of the individual, the individual's spouse or common-law partner and members of the individual's household.

ITA
20.01(2)(*b*)(i)(A)(II)

The reference in the English version of subclause 20.01(2)(*b*)(i)(A)(II) of the Act to the term "majority interest partner" is replaced with a reference to "majority-interest partner". This amendment is consequential on a similar amendment to the definition "majority-interest partner" in subsection 248(1). For further information, see the commentary on that definition.

This amendment comes into force on Royal Assent.

Clause 13

Farming or fishing business

ITA
28(1)(*a*)

Subsection 28(1) of the Act provides for a method of accounting, known as the cash-basis method, which may be used for computing income or loss from a business of farming or fishing. Paragraph 28(1)(*a*) is amended to delete the word "and", which is unnecessary, at the end of the paragraph and to update its language.

This amendment comes into force on Royal Assent.

Clause 14

Restricted farm loss

ITA
31(1)

Subsection 31(1) of the Act restricts the farming losses deductible by a taxpayer against income from other sources in a taxation year unless the taxpayer's chief source of income for the year is farming or a combination of farming and some other source of income. This restriction ensures that taxpayers for whom farming is not the principal occupation are limited in their ability to deduct from their non-farm income losses from farming. Farming losses are computed in accordance with favourable farm tax rules which could include the cash method of accounting under section 28.

The unrestricted portion of such farm losses is limited to $2,500 plus ½ of the next $12,500 of losses. The remainder of such a loss is defined, for the purposes of the Act, as a "restricted farm loss". A restricted farm loss for a taxation year is deductible under paragraph 111(1)(*c*) in computing taxable income for the three preceding taxation years or the 20 following taxation years to the extent of the taxpayer's income from farming in those years.

Subsection 31(1) is amended to codify the interpretation of subsection 31(1) set out in the Supreme Court of Canada's decision in *Moldowan v. The Queen*, [1978] 1 SCR 480. Specifically, the amendment clarifies that a taxpayer will be limited to the deduction in respect of farm losses set out in subsection 31(1) if the taxpayer does not look to farming, or to farming and some subordinate source of income, for their livelihood. This amendment replaces the interpretation placed on section 31 by the Supreme Court of Canada in its decision in *The Queen v. Craig,* 2012 SCC 43, and applies to taxation years that end after March 20, 2013.

In addition, subparagraphs 31(1)(*a*)(i) and (*b*)(i) are amended to delete their reference to section 37.1, which has been repealed. The amendments to subparagraphs 31(1)(*a*)(i) and (*b*)(i) apply to taxation years that end after March 20, 2013.

Finally, for taxation years that end after March 20, 2013, clause 31(1)(*a*)(ii)(B) is amended to increase the unrestricted portion of losses from farming for a taxpayer that is limited by subsection 31(1) to $2,500 plus ½ of the next $30,000 of losses.

Farming and manufacturing or processing

ITA
31(2)

Existing subsection 31(2) of the Act provides that the Minister of National Revenue may determine that a taxpayer's chief source of income for a year is neither farming nor a combination of farming and some other source. Existing subsection 31(2) is repealed and replaced by a new provision.

New subsection 31(2) sets out the circumstances under which subsection 31(1) will not apply to a taxpayer. In particular, subsection 31(2) provides that the restrictions on farm losses in subsection 31(1) will not apply where the taxpayer's chief source of income is a combination of farming and manufacturing or processing in Canada of goods for sale, and all or substantially all of the output from all of the taxpayer's farming businesses is used in the manufacturing or processing. Subsection 31(2) is relevant in cases where the taxpayer's chief source of income is farming and manufacturing or processing, but manufacturing and processing is not subordinate to the taxpayer's farming source of income.

Subsection 31(2) applies to taxation years that end after March 20, 2013.

Clause 15

Deemed December 31, 1995 income

ITA
34.1(4) to (7)

Subsections 34.1(4) to (7) of the Act relate to transitional relief available to individuals in respect of the "December 31, 1995 income" from carrying on business as proprietors or partners in 1995. Subsections 34.1(4) to (7) are repealed as a consequence of the expiry of the transitional relief associated with an individual's "December 31, 1995 income".

This amendment comes into force on Royal Assent.

Clause 16

Corporate partners

ITA
34.2

Section 34.2 of the Act provides rules that adjust a corporate partner's income to limit the deferral of tax where the partnership has a fiscal period that differs from the corporation's taxation year. Existing section 34.2 relies on subsection 34.2(5) to characterize and to determine the proportion of income amounts and capital amounts that make up a corporation's adjusted stub period accrual income in respect of a partnership for a taxation year. Such amounts then become deductible, as appropriate, for the corporation's immediately following taxation year.

Section 34.2 is amended to clarify the operation of the section, particularly with respect to the conversion of an amount deemed to be a taxable capital gain for a taxation year (e.g., under subsection 34.2(2)) into an offsetting allowable capital loss for the immediately following year.

Treatment in following year

ITA
34.2(4)

Subsection 34.2(4) of the Act provides that a corporation may deduct in computing its income for a taxation year the amount that was included in computing its income in respect of a partnership for the immediately preceding taxation year under either of subsection 34.2(2) or (3).

Subsection 34.2(4) is amended to refer to the adjusted stub period accrual income characterization and proportion rules found in subparagraphs 34.2(5)(*a*)(i) and (ii) and to introduce new paragraphs 34.2(4)(*a*) and (*b*).

New paragraph 34.2(4)(*a*) provides that the "income" portion of a corporate partner's adjusted stub period accrual in respect of a partnership for the immediately preceding taxation year under subsection 34.2(2) or (3), as the case may be, is deductible in computing the corporate partner's income for the current taxation year. New paragraph 34.2(4)(*b*) provides that the "taxable capital gains" portion of a corporate partner's adjusted stub period accrual in respect of a partnership for the immediately preceding taxation year is deemed to be an allowable capital loss of the corporation for the current taxation year from the disposition of property.

This amendment applies to taxation years that end after March 22, 2011.

Character of amounts

ITA
34.2(5)

Subsection 34.2(5) of the Act provides rules for characterizing the nature of, and for determining the proportions of, the income that makes up a corporate partner's adjusted stub period accrual in respect of a partnership for the purposes of the rules that adjust a corporate partner's income. Subsection 34.2(5) is amended in the following respects.

First, consequential on the amendment of subsections 34.2(4), (11) and (12), subparagraphs 34.2(5)(*a*)(i) to (v) are amended as follows:

- subparagraphs 34.1(5)(*a*)(i) and (ii) – it is clarified that amounts deemed by those subparagraphs to be taxable capital gains are “from the disposition of property” to conform with the requirements of paragraph 3(*b*);
- subparagraph 34.2(*a*)(iii) – the reference to an amount “deductible” under subsection 34.2(4) is replaced with an amount “a portion of which is deductible or is an allowable capital loss” under subsection 34.2(4);
- subparagraph 34.2(5)(*a*)(iv) – the reference to the amount “deductible as a reserve” under subsection (11) is replaced with “claimed as a reserve” under subsection 34.2(11); and
- subparagraph 34.2(5)(*a*)(v) – amendments are made to refer to
    - the portion of an amount that “is included in income under paragraph (12)(*a*), or is deemed to be a taxable capital gain under paragraph (12)(*b*)”, instead of referring to the “amount included in income” under subsection 34.2(12), and
    - the amount “claimed” as a reserve under subsection 34.2(11) in the immediately preceding taxation year instead of to the amount “deducted” under subsection 34.2(11).

Second, consequential on the amendments to provide for deemed allowable capital losses in subsections 34.2(4) and (11), the current deemed capital loss rule in paragraph 34.2(5)(*b*) is repealed and replaced by a new paragraph 34.2(5)(*b*).

Third, new paragraph 34.2(5)(*b*) provides that a corporation’s capital dividend account, as defined in subsection 89(1), is to be determined without reference to section 34.2. Although the explanatory note for existing subsection 34.2(5) indicates that a corporate partner’s deemed taxable capital gains and allowable capital losses in respect of adjusted stub period accrual do not result in adjustments to a corporate partner’s capital dividend account, it is now necessary to provide a rule for this result because such taxable capital gains and allowable capital losses are now deemed to be “from the disposition of property”. Adjustments to a corporate partner’s capital dividend account for actual capital gains and capital losses included in the partner’s “eligible alignment income” in respect of a partnership (for which an election was made to align its fiscal period with a corporate partner’s taxation year), are to be made without reference to a reserve that may be claimed by the corporate partner in respect of that eligible alignment income under the rules applicable to qualifying transitional income under subsection 34.2(11).

Fourth, new paragraph 34.2(5)(*c*) provides that the reference in subparagraph 53(2)(*c*)(i.4) to an amount deducted under subsection 34.2(11) by a taxpayer includes an amount deemed to be an allowable capital loss under subparagraph 34.2(11)(*b*)(ii).

These amendments apply to taxation years that end after March 22, 2011.

Transitional reserve

ITA
34.2(11)

Subsection 34.2(11) of the Act sets out the deduction that a corporation may claim as a transitional reserve, consequential on the enactment of the corporate partnership deferral rules in subsections 34.2(1) to (10). In any particular taxation year, a corporation that has qualifying transitional income (QTI) in respect of a partnership may deduct, as a reserve, under subsection 34.2(11) an amount not exceeding the least of three amounts.

Subsection 34.2(11) is amended in two respects. First, the three maximum reserve limits set out in existing paragraphs 34.2(11)(*a*) to (*c*) are moved to new subparagraphs 34.2(11)(*a*)(i) to (iii). This change is necessary as a consequence of clarifying that, while a corporate partner may claim a reserve for QTI in respect of a partnership, the income and capital nature of the corporation's claim is provided for in new paragraph 34.2(11)(*b*). Two additional amendments are made in respect of existing paragraphs 34.2(11)(*b*) and (*c*):

- Existing paragraph 34.2(11)(*b*) – which becomes new subparagraph 34.2(*a*)(ii) – is amended to replace the reference to "deductible" with "claimed" consequential on the introduction of new paragraph 34.2(11)(*b*).
- Existing paragraph 34.2(11)(*c*) – which becomes new subparagraph 34.2(11)(*a*)(iii) – is amended to refer to dividends deductible under section 112 or 113 in respect of a dividend received by the corporation after December 20, 2012. Existing paragraph 34.2(11)(*c*) provides, in general, that a corporation's deduction under subsection 34.2(11) for a taxation year cannot exceed the corporation's income before deducting any amount under subsection 34.2(11) in respect of the partnership or under sections 61.3 and 61.4. In effect, paragraph 34.2(11)(*c*) limits a corporation's maximum reserve for QTI in a year to no more than the corporation's income for the year computed before claiming the reserve. The reference in existing paragraph 34.2(11)(*c*) to computing income does not refer to amounts that are only deductible in respect of computing a corporation's "taxable income". Accordingly, new subparagraph 34.2(11)(*a*)(iii) provides that a corporation's income is also reduced by dividends received by the corporation after December 20, 2012 that are deductible under section 112 or 113 in computing the corporation's taxable income.

Second, new paragraph 34.2(11)(*b*) provides that the portion of the amount claimed as a reserve by a corporate partner under paragraph 34.2(11)(*a*) for the particular year that, because of subparagraph (5)(*a*)(iv), has

- a character other than capital is deductible in computing the income of the corporation for the particular year, and
- the character of capital is deemed to be an allowable capital loss of the corporation for the particular year from the disposition of property.

This amendment applies to taxation years that end after March 22, 2011.

Inclusion of prior year reserve

ITA
34.2(12)

Subsection 34.2(12) of the Act provides that a corporation is required to include in computing its income from a partnership for a taxation year the amount claimed as a reserve by the corporation under subsection 34.2(11) in respect of the partnership for the immediately preceding taxation year.

Subsection 34.2(12) is amended to provide for an inclusion of a corporation's prior year reserve in income under new paragraphs 34.2(12)(*a*) and (*b*). Which paragraph applies in the current year to a corporate partner's reserve claim for the immediately preceding taxation year depends on the portion of the prior year claim that was deducted under subparagraph 34.2(11)(*b*)(i) in that prior year and the portion that was deemed to be an allowable capital loss in that prior year by subparagraph 34.2(11)(*b*)(ii).

New paragraph 34.2(12)(*a*) provides that the portion of the reserve that was a deduction in computing income for the immediately preceding taxation year is to be included in computing the corporate partner's income for the current taxation year. The portion of the prior year's reserve claim that was an allowable capital loss is deemed by paragraph 34.2(12)(*b*) to be a taxable capital gain of the corporation for the current taxation year from the disposition of property.

This amendment applies to taxation years that end after March 22, 2011.

No reserve

ITA
34.2(13)

Subsection 34.2(13) of the Act sets out the circumstances under which a corporation may not deduct, as a reserve, an amount in respect of a partnership under subsection 34.2(11). Subsection 34.2(13) is amended to replace the reference to "deduct" with "claim" consequential on other amendments to section 34.2.

This amendment applies to taxation years that end after March 22, 2011.

Deemed partner

ITA
34.2(14)

Subsection 34.2(14) of the Act provides that a corporation that may not deduct an amount under subsection 34.2(11) in respect of a partnership solely because it disposed of its interest in the partnership, is deemed to be a member of the partnership for the purposes of subsection 34.2(13) if certain conditions are met. Subsection 34.2(14) is amended to replace the reference to "deduct" with "claim" consequential on other amendments to the section 34.

This amendment applies to taxation years that end after March 22, 2011.

Qualifying transition income adjustment – conditions for application

ITA
34.2(16)

Subsection 34.2(16) of the Act sets out a two-prong test for determining if subsection 34.2(17) applies for a particular taxation year (and each subsequent taxation year) of a corporation for which the corporation may deduct an amount, as a reserve, under subsection 34.2(11). Subsection 34.2(16) is amended to replace the reference to "deduct" with "claim" consequential on other amendments to section 34.

This amendment applies to taxation years that end after March 22, 2011.

Adjustment of qualifying transitional income

ITA
34.2(17)(*b*)

Subsection 34.2(17) of the Act provides two rules that apply to adjust the amount of a corporation's adjusted stub period accrual that is included in the corporation's qualifying transitional income (QTI) in respect of a particular partnership. This adjustment occurs only once, and in the "particular taxation year" identified by subsection 34.2(16). Once the adjustment to a corporation's QTI in respect of a

particular partnership is made, that QTI, as adjusted, is the corporation's QTI in respect of the partnership for the particular taxation year and each subsequent taxation year.

In general, although a corporation's adjusted stub period accrual initially included in its QTI in respect of a partnership is calculated based on the fiscal period(s) of the partnership that ended in the corporation's first taxation year ending after March 22, 2011, the rules in subsection 34.2(17) refer to the "particular period" of the partnership. The particular period of the partnership is its fiscal period that begins in the corporation's first taxation year for which the QTI was initially calculated and ends in the corporation's taxation year (i.e., the particular taxation year).

Once the particular period of the partnership ends in the particular taxation year of the corporation, the corporation is allocated its share of the partnership's income or loss for the particular period. Therefore, the corporation knows the actual portion of that income (loss) that should be the corporation's adjusted stub period accrual included in its QTI. The corporation's QTI may increase or decrease, depending on the particular case.

No adjustment of QTI occurs if it includes only "eligible alignment income" because such income is not subject to a similar adjustment.

Paragraph 34.2(17)(*b*) provides a read-as rule for the formula in subparagraph (*b*)(ii) of the definition "adjusted stub period accrual" in subsection 34.2(1), which applies in the case of certain multi-tier alignments of the fiscal periods of tiered partnerships. Although the read-as formula in paragraph 34.2(17)(*b*) is meant to adjust a corporation's QTI so that it is not over or understated, the description of C in the read-as formula currently requires a reduction of a corporation's "adjusted stub period accrual" in its QTI equal to the corporation's eligible alignment income for the eligible fiscal period. This reduction is appropriate in year one, when a corporation's QTI in respect of a partnership is being estimated, but is inappropriate under the read-as formula when "truing-up" the portion of a corporation's QTI in year two that concerns its adjusted stub period accrual for the particular period of the partnership. Accordingly, the description of C in the formula in paragraph 34.2(17)(*b*) is amended to be Nil.

This amendment applies to taxation years that end after March 22, 2011.

Clause 17

Railway companies

ITA
36

Section 36 of the Act generally provides that an expenditure that is made by a railway company in respect of the repair, replacement, alteration or renovation of a depreciable property and that is required by the National Transportation Agency to be capitalized for regulatory rate-setting purposes must also be capitalized for income tax purposes (i.e., the railway company is deemed to have acquired a depreciable property).

Section 36 is repealed. As a result, these expenditures will now be subject to the same income tax rules and principles as when they are incurred by other taxpayers.

This repeal applies to expenditures incurred in taxation years that begin after December 21, 2012.

Clause 18

Scientific research and experimental development

ITA
37

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

ITA
37(1)(*h*) and (6.1)

Subsection 37(1) of the Act permits a taxpayer carrying on business in Canada in a taxation year to deduct, in computing the taxpayer's income from a business for the year, certain current and capital expenditures incurred in respect of SR&ED carried on in Canada. The maximum amount deductible for a year, which is accumulated in a pool, is computed under paragraphs 37(1)(*a*) to (*h*). Under paragraph 37(1)(*h*), if the taxpayer is a corporation the control of which is acquired before the end of the year, the pool is reduced by the amount determined for the year under subsection 37(6.1) with respect to the taxpayer. The effect of these rules is to restrict the ability of a corporation, that is subject to an acquisition of control, to carry forward to the current year expenditures incurred in a year prior to the acquisition of control. In general terms, the undeducted SR&ED expenditures from before the acquisition of control may be carried forward for use in the current year only if the business to which the expenditures relate is carried on throughout the current year by the corporation for profit or a reasonable expectation of profit and only to the extent of its income for the current year.

Paragraph 37(1)(*h*) and subsection 37(6.1) are amended to extend their application to trusts, by referring to a taxpayer that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

These amendments come into force on March 21, 2013.

ITA
37(9.5)(*b*)

The reference in the English version of paragraph 37(9.5)(*b*) of the Act to the term "majority interest partner" is replaced with a reference to "majority-interest partner". This amendment is consequential on a similar amendment to the definition "majority-interest partner" in subsection 248(1). For further information, see the commentary on that definition.

This amendment comes into force on Royal Assent.

Clause 19

Capital gains and losses – general rules

ITA
40

Section 40 of the Act provides rules for determining a taxpayer's gain or loss from the disposition of capital property.

Limitations

ITA
40(2)(*a*)(iii)

Paragraph 40(2)(*a*) of the Act generally restricts a taxpayer's ability to claim a capital gains reserve in respect of properties disposed of to a non-resident or to a corporation that controlled the taxpayer or was controlled by the taxpayer. Subparagraph 40(2)(*a*)(iii) specifies the claim of a capital gains reserve is also restricted if the purchaser of the property sold is a partnership in which the taxpayer is a majority interest partner.

The reference in the English version of subparagraph 40(2)(*a*)(iii) of the Act to the term "majority interest partner" is replaced with a reference to "majority-interest partner". This amendment is consequential on a similar amendment to the definition "majority-interest partner" in subsection 248(1). For further information, see the commentary on that definition.

This amendment comes into force on Royal Assent.

ITA
40(3.4)(*b*)(iii)

Subsections 40(3.3) to (3.6) of the Act defer, in certain circumstances, the realization of a loss that would otherwise arise from certain dispositions by a corporation, trust or partnership (the transferor) of a non-depreciable capital property. If the transferor or an affiliated person acquires the property (or an identical property) in the period that begins 30 days before the disposition and ends 30 days after the disposition and the transferor or an affiliated person owns the property at the end of that period, the transferor's loss from the disposition is deemed to be nil and the loss is suspended until the earliest of certain so-called "release events" described in subparagraph 40(3.4)(*b*)(i) to (v).

One such release event, described in subparagraph 40(3.4)(*b*)(iii), is, if the transferor is a corporation, the acquisition of control of the transferor. Subparagraph 40(3.4)(*b*)(iii) is amended, to extend its application to trusts, by referring to a transferor that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

ITA
40(10) and (11)

Subsections 40(10) and (11) of the Act provide a mechanism for the computation of the gain or loss on a foreign currency debt that takes into account the impact of gains and losses already recognized in respect of a foreign currency debt because of subsection 111(12). Subsection 111(12) extends the general treatment of accrued capital gains and losses on an acquisition of control of a corporation to apply also to a corporation's accrued capital gains and capital losses resulting from foreign currency fluctuations on debt liabilities denominated in a foreign currency. The mechanism under subsections 40(10) and (11) is necessary because, unlike gains and losses in respect of property, gains and losses from a fluctuation in the value of the currency of a foreign currency debt of the corporation are not referable to a cost base that may be adjusted to account for previously recognized gains and losses.

Subsections 40(10) and (11) are amended to extend their application to trusts. These changes are consequential on the extension of the rules in subsection 111(4) and (12) to trusts. For further information, see the commentary on sections 111 and 251.2.

These amendments come into force on March 21, 2013.

Clause 20

Where a reserve may not be claimed

ITA
44(7)(*c*)

Subsection 44(7) of the Act restricts a taxpayer from claiming a capital gains reserve under subparagraph 44(1)(*e*)(iii) where the former property of the taxpayer was disposed of to a non-resident or a corporation that, immediately after the disposition, controlled the taxpayer or was controlled by the taxpayer or by a person or group of persons who controlled the taxpayer. Paragraph 44(7)(*c*) provides that the capital gains reserve is also not allowed to a taxpayer where the purchaser of the property is a partnership of which the taxpayer is a majority interest partner.

The reference in the English version of paragraph 44(7)(*c*) of the Act to the term “majority interest partner” is replaced with a reference to “majority-interest partner”. This amendment is consequential on a similar amendment to the definition “majority-interest partner” in subsection 248(1). For further information, see the commentary on that definition.

This amendment comes into force on Royal Assent.

Clause 21

Debts established to be bad debts and shares of bankrupt corporation

ITA
50(1)(*b*)(i)

Paragraph 50(1)(*b*) of the Act treats a taxpayer as having disposed of a share of the capital stock of a corporation owned at the end of the year in which the taxpayer becomes bankrupt (under the *Bankruptcy and Insolvency Act*) or insolvent (under the *Winding-up and Restructuring Act*) and as having reacquired the share at a nil cost immediately thereafter.

Subparagraph 50(1)(*b*)(i) is amended to remove a reference to subsection 128(3) as the definition “bankrupt” is now in subsection 248(1).

This amendment comes into force on December 21, 2012.

Clause 22

Adjustments to cost base

ITA
53

Section 53 of the Act contains rules for determining the adjusted cost base (ACB) of property. Certain adjustments are made under this section. Subsection 53(1) provides for additions in computing the ACB of a property. Subsection 53(2) provides for deductions in computing the ACB of a property.

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

Paragraph 53(1)(*e*) of the Act provides for additions to the adjusted cost base of a taxpayer’s partnership interest. Clause 53(1)(*e*)(i)(A) is amended to add a reference to paragraph 38(*a.3*). This

amendment provides that the adjusted cost base of a partnership interest is to be calculated without reference to paragraph 38(*a.3*) and ensures that the non-taxable portion of the gain from an exchange, under paragraph 38(*a.3*), of an interest in a partnership for a publicly traded security is properly added to the adjusted cost base under paragraph 53(1)(*e*).

This amendment applies in respect of gifts made after February 25, 2008.

ITA
53(1)(*r*)

Paragraph 53(1)(*r*) of the Act increases the adjusted cost base of a taxpayer's interest in, or share of the capital stock of, a flow-through entity disposed of by the taxpayer before 2005 that is described in any of paragraphs (*a*) to (*f*) of the definition "flow-through entity" in subsection 39.1(1). The adjusted cost base is increased by a pro-rata portion of the amount of the individual's unused exempt gains balance in respect of the entity if the taxpayer disposes of all their interests in and shares of the capital stock of the entity.

Paragraph 53(1)(*r*) is amended to add a reference to an entity described in paragraph (*h*) of the definition "flow-through entity" in subsection 39.1(1). This permits the adjustment of the adjusted cost base of a taxpayer's interest in a trust described in paragraph (*h*) of the definition (i.e., a trust created to hold shares of the capital stock of a corporation for the benefit of its employees).

This amendment applies to dispositions that occur after 2001.

ACB adjustment – derivative forward agreement

ITA
53(1)(*s*) and (*t*)

New paragraphs 53(1)(*s*) and (*t*) of the Act provide an increase in the adjusted cost base of a property where there has been an inclusion in the computation of a taxpayer's income because of paragraph 12(1)(*z.7*). This adjustment is provided to ensure that an amount included in computing a taxpayer's income under paragraph 12(1)(*z.7*) is not taxed again as a capital gain.

Paragraph 53(1)(*s*) applies in respect of a purchase of property under a derivative forward agreement. Any amount required to be included in respect of the purchase of the property under subparagraph 12(1)(*z.7*)(i) is added to the adjusted cost base of the property.

Paragraph 53(1)(*t*) applies in respect of a sale of property under a derivative forward agreement. Any amount required to be included in respect of the sale of the property under subparagraph 12(1)(*z.7*)(ii) is added to the adjusted cost base of the property. This adjustment occurs for the year of sale so that it is taken into account in computing any gain or loss on the sale.

An income inclusion is provided in paragraph 12(1)(*z.7*) where a derivative forward agreement results in a profit. A deduction is provided in paragraph 20(1)(*xx*) where a derivative forward agreement results in a loss. A decrease in the adjusted cost base of the capital property is provided in paragraphs 53(2)(*w*) and (*x*) where an amount is deductible under paragraph 20(1)(*xx*).

For further information, see the commentary on paragraphs 12(1)(*z.7*), 20(1)(*xx*) and 53(2)(*w*) and (*x*) and the definition "derivative forward agreement" in subsection 248(1).

Paragraphs 53(1)(*s*) and (*t*) come into force on March 21, 2013.

Flow-through entity before 2005

ITA
53(1.2)

New subsection 53(1.2) of the Act provides that, for the purposes of the calculation in the formula in paragraph 53(1)(*r*), if the fair market value of all of a taxpayer's interests in, or shares of, a flow-through entity described in that paragraph is nil at the time of their disposition, the fair market value of each interest or share in the entity is deemed to be $1. This amendment is necessary in order to permit a calculation to be made for the formula in paragraph 53(1)(*r*) where the fair market value of all taxpayer's interests in the entity is nil at the time of disposition.

This amendment applies to dispositions that occur after 2001.

ACB adjustment – loss restriction event

ITA
53(2)(*b.2*)

Paragraph 53(2)(*b.2*) of the Act requires a deduction in computing the ACB of non-depreciable capital property of a corporation that has been subject to an acquisition of control. The amount of the deduction is determined under paragraph 111(4)(*c*).

Paragraph 53(2)(*b.2*) is amended to extend its application to trusts, consequential on an amendment to subsection 111(4) to extend that subsection to trusts. Amended subsection 111(4) applies to a taxpayer that is a corporation or trust as a result of the taxpayer being subject to a loss restriction event. For further information, see the commentary on sections 111 and 251.2.

This amendment comes into force on March 21, 2013.

ACB adjustment – derivative forward agreement

ITA
53(2)(*w*) and (*x*)

New paragraphs 53(2)(*w*) and (*x*) of the Act provide a decrease in the adjusted cost base of a property where there is an amount deductible under paragraph 20(1)(*xx*) in computing a taxpayer's income. This adjustment is provided to ensure that an amount deductible in computing a taxpayer's income under paragraph 20(1)(*xx*) cannot be deducted as a capital loss.

Paragraph 53(2)(*w*) applies in respect of a purchase of the property under a derivative forward agreement. Any amount deductible in computing the taxpayer's income in respect of the purchase of the property under paragraph 20(1)(*xx*) is subtracted from the adjusted cost base of the property.

Paragraph 53(2)(*x*) applies in respect of a sale of the property under a derivative forward agreement. Any amount deductible in computing the taxpayer's income in respect of the sale of the property under paragraph 20(1)(*xx*) is subtracted from the adjusted cost base of the property. This adjustment occurs for the year of sale so that it is taken into account in computing any gain or loss on the sale.

An income inclusion is provided in paragraph 12(1)(*z.7*) where a derivative forward agreement results in a profit. A deduction is provided in paragraph 20(1)(*xx*) where a derivative forward agreement results in a loss. An increase in the adjusted cost base of the capital property purchased or sold is provided in paragraphs 53(1)(*s*) and (*t*) where an amount is included in a taxpayer's income under paragraph 12(1)(*z.7*).

For further information, see the commentary on paragraphs 12(1)(*z.7*), 20(1)(*xx*) and 53(1)(*s*) and (*t*) and the definition “derivative forward agreement” in subsection 248(1).

Paragraphs 53(2)(*w*) and (*x*) come into force on March 21, 2013.

Clause 23

Definitions

ITA
54

Section 54 of the Act contains various definitions that apply for the purposes of subdivision c – Taxable Capital Gains and Allowable Capital Losses.

“superficial loss”

The definition “superficial loss” in section 54 excludes losses on dispositions listed in paragraphs (*c*) to (*h*) of the definition from being superficial losses. Paragraph (*c*) of the definition is amended to remove its reference to paragraph 33.1(11)(*a*), which has been repealed.

This amendment applies to taxation years that begin after March 20, 2013.

Paragraph (*f*) of the definition describes a disposition by a corporation control of which has been acquired within 30 days after the disposition. Paragraph (*f*) of the definition is amended to extend its application to trusts, by referring to a taxpayer that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

Clause 24

Anti-avoidance – capital gains stripping

ITA
55

In general terms, section 55 of the Act is an anti-avoidance provision directed against arrangements designed to use the inter-corporate dividend exemption to unduly reduce a capital gain on the disposition of shares. If the section applies, the dividend is treated as proceeds of disposition from the disposition of the shares (i.e., as a capital gain) and not as a dividend received by the corporation. Section 55 also includes two broad-based exemptions from its application. Paragraph 55(3)(*a*) provides an exemption for dividends received in certain “related” situations. Paragraph 55(3)(*b*) provides an exemption for dividends received in the course of certain corporate reorganizations commonly referred to as divisive or butterfly reorganizations.

Section 55 is amended to make a number of relieving changes that have been outlined in various comfort letters issued by the Department of Finance since October 2004. These changes address technical concerns regarding the application of section 55 in a manner consistent with the tax policy underlying the section. One change is also made to address a technical issue that has been brought to the attention of the Department of Finance.

Application of two exemptions

ITA
55(3)

Subsection 55(3) of the Act provides two exemptions from the anti-avoidance rule in subsection 55(2) that deems certain deemed dividends received in the course of a corporate reorganization to be a capital gain. Paragraph 55(3)(*a*) provides an exemption for dividends received in the course of certain related-party transactions. More specifically, paragraph 55(3)(*a*) exempts a dividend received by a corporation if, as part of a transaction or event or series of transactions or events that includes the receipt of the dividend, there was not a disposition of property or a significant increase in the total direct interest in a corporation described in subparagraphs 55(3)(*a*)(i) to (v).

Paragraph 55(3)(*b*) provides an exemption for dividends received in the course of certain corporate reorganizations commonly referred to as divisive or butterfly reorganizations. A butterfly reorganization involves a series of transactions whose objective is to distribute property of a distributing corporation pro rata among its corporate shareholders on a tax-deferred basis.

ITA
55(3)(*a*)(iii)(B)

Clause 55(3)(*a*)(iii)(B) of the Act describes a disposition, to a person or partnership that is unrelated to the dividend recipient, of property (other than shares of the dividend recipient) more than 10% of the fair market value of which is derived at any time during the series from shares of the capital stock of the dividend payer. In such a case, the exemption from the anti-avoidance rule in subsection 55(2) for certain related-party transactions does not apply. Clause 55(3)(*a*)(iii)(B) is amended to extend its application to property more than 10% of the fair market value of which is derived during the course of the series from "any combination of shares of the capital stock and debt" of the dividend payer.

ITA
55(3)(*a*)(iv)(B)

Clause 55(3)(a)(iv)(B) of the Act describes a disposition after the dividend is received, to a person or partnership that is unrelated to the dividend recipient, of property more than 10% of the fair market value of which is derived at any time during the course of the series from shares of the capital stock of the dividend recipient. In such a case, the exemption from the anti-avoidance rule in subsection 55(2) for certain related-party transactions does not apply. Clause 55(3)(*a*)(iv)(B) is amended to extend its application to property more than 10% of the fair market value of which is derived at any time during the course of the series from "any combination of shares or the capital stock and debt" of the dividend recipient.

These amendments apply in respect of dividends received after December 20, 2012.

Interpretation for paragraph 55(3)(*a*)

ITA
55(3.01)

Paragraphs 55(3.01)(*a*) to (*e*) of the Act contain various interpretative rules for the purposes of the exemption from subsection 55(2) that is found in paragraph 55(3)(*a*) for certain related-party transactions. Subsection 55(3.01) is amended to add three interpretative rules consistent with comfort letters issued by the Department of Finance.

ITA
55(3.01)(*f*)

The first amendment relates to a Department of Finance comfort letter dated October 16, 2007 concerning subparagraph 55(3)(*a*)(ii), which provides an exemption from the application of subsection 55(2). This exemption does not apply if there is a significant increase in the total direct interest in any corporation held by one or more persons or partnerships who are unrelated persons.

In general terms, new paragraph 55(3.01)(*f*) provides that the exemption provided by subparagraph 55(3)(*a*)(ii) will apply if there is a significant increase in the total direct interest in a corporation that results from the issuance of shares of the capital stock of the corporation solely for money, provided that the shares are redeemed, acquired or cancelled by the corporation before the dividend is received. The issue that paragraph 55(3.01)(*f*) addresses is discussed in the following excerpt from a Department of Finance comfort letter dated October 16, 2007:

> *Parentco is a widely-held publicly-traded corporation. It owns indirectly, 100% of the shares of Subco 1, a taxable Canadian corporation. A subsidiary corporation controlled by Parentco ("Acquireco") acquires all the issued and outstanding shares of another corporation ("Targetco") such that Targetco becomes a wholly-owned subsidiary of Acquireco. Targetco controls another corporation ("Subco 2"). In consideration for the shares of Targetco, the Targetco shareholders receive money and shares of Parentco. Acquireco partly finances the cash portion of the takeover by issuing shares of its capital stock ("financing shares") solely for money to another corporation ("Finco") that is unrelated to Acquireco. Before the post-takeover internal reorganization (described below) is undertaken, the financing shares are redeemed, with the result that Finco no longer has an interest in Acquireco.*
>
> *Following the acquisition of Targetco and after the cancellation of the financing shares, Parentco undertakes an internal reorganization that results in taxable dividends being received by Subco 1 and Subco 2. At no time before the end of the series of transactions or events that includes the receipt of the dividends will Subco 1 and Subco 2 cease to be controlled by Parentco.*
>
> *Your concern is that subsection 55(2) of the Act will apply to the dividends that will be received in the course of the internal reorganization because the increase in interest in Acquireco by Finco will be described in subparagraph 55(3)(a)(ii) of the Act. You submit that the application of subsection 55(2) of the Act to the dividends to be received on the internal reorganization would not be appropriate since the increase in interest in Acquireco by Finco occurs as part of a financing transaction that is completed before the internal reorganization. Moreover, the transactions do not result in a tax-deferred disposition of the assets of the dividend payer or dividend recipient outside the Parentco group.*

ITA
55(3.01)(*g*)

The second amendment relates to a Department of Finance comfort letter dated September 6, 2006 concerning subparagraphs 55(3)(*a*)(i) and (ii), which provide exemptions from subsection 55(2). Subparagraph 55(3)(*a*)(i) describes the disposition of property to an unrelated person or partnership, and subparagraph 55(3)(*a*)(ii) describes a significant increase in the total direct interest of an unrelated person or partnership in a corporation.

In general terms, new paragraph 55(3.01)(*g*) provides that subsection 55(2) does not apply in certain circumstances where there is a disposition of property otherwise described in subparagraph 55(3)(*a*)(i) or where there is a significant increase in the total direct interest in a corporation otherwise described in subparagraph 55(3)(*a*)(ii). This paragraph applies where five conditions are met:

- The dividend payer is related to the dividend recipient immediately before the dividend is received.
- The dividend payer did not, as part of the series of transactions or events that includes the receipt of the dividend, cease to be related to the dividend recipient.
- The disposition or increase occurred before the dividend was received.
- The disposition or increase was the result of the disposition of shares to, or the acquisition of shares of, a particular corporation.
- At the time the dividend was received, all the shares of the capital stock of the dividend recipient and the dividend payer were owned by the particular corporation, a corporation that controlled the particular corporation, a corporation controlled by the particular corporation or any combination of those corporations.

The issue that paragraph 55(3.01)(*g*) addresses is set out in the following excerpt from a Department of Finance comfort letter dated September 6, 2006:

> *The series of transactions or events in issue ("relevant series") includes the disposition of the shares of a publicly-traded corporation ("Targetco") to another publicly-traded corporation ("Acquireco") such that Targetco will become a wholly-owned subsidiary of Acquireco. Following the disposition of the Targetco shares to Acquireco, an indirect wholly-owned subsidiary of Targetco ("T Sub") will undertake an internal reorganization that will result in dividends being received by T Sub and another indirect wholly-owned subsidiary of Targetco ("Newco"). More specifically, the transactions or events that will occur as part of the relevant series are as follows:*
>
> > *(a) The Targetco shareholders will dispose of their shares of Targetco to Acquireco in consideration for shares of Acquireco. The disposition of the Targetco shares by the Targetco shareholders will occur for proceeds of disposition that are less than fair market value or will be deemed by paragraph 55(3.01)(e) of the Act to occur at less than fair market value.*
> >
> > *(b) The parent of T Sub will transfer some of its shares of T Sub to Newco in consideration for shares of Newco. The fair market value of the transferred T Sub shares will be equal to the fair market value of the transferred assets referred to in paragraph (c).*
> >
> > *(c) T Sub will transfer some of its assets to Newco in exchange for preferred shares of Newco with a fair market value and redemption value equal to the transferred assets. T Sub and Newco will jointly elect under subsection 85(1) to effect the transfer on a tax-deferred basis.*
> >
> > *(d) Newco will redeem the Newco preferred shares for a promissory note and T Sub will purchase for cancellation the shares of its capital stock owned by Newco for a promissory note. The promissory notes will be offset and cancelled. The redemption of*

the Newco preferred shares and the cancellation of the T Sub shares would result in deemed dividends being received by T Sub and Newco. Newco and T Sub will each be a taxable Canadian corporation and, as a result, the deemed dividends will be deductible to T Sub and Newco under subsection 112(1) of the Act.

(e) The parent of T Sub will transfer the shares of T Sub to an indirect wholly-owned subsidiary of Acquireco ("A Sub") for fair market value. T Sub will be wound up into A Sub under subsection 88(1). Pursuant to paragraph 55(3.01)(c) of the Act, A Sub will be deemed, for the purpose of paragraph 55(3)(a), to be the same corporation and a continuation of T Sub.

You advised us that, at no time before the end of the relevant series, will more than 10% of the fair market value of the Acquireco shares or the Targetco shares be derived from the shares of either Newco, T Sub or A Sub. In addition, T Sub and Newco will not cease to be related as part of the relevant series.

Your concern is that subsection 55(2) of the Act will apply to the dividends that will be received by T Sub and Newco in the course of the internal reorganization because

(a) the disposition of the Targetco shares to Acquireco is described in subparagraph 55(3)(a)(i); and

(b) the increase in interest in Acquireco by the Targetco shareholders is described in subparagraph 55(3)(a)(ii).

ITA
55(3.01)(*h*)

The third amendment concerns paragraphs 55(3.01)(*b*) and (*c*). Paragraphs 55(3.01)(*b*) and (*c*) deem an amalgamated corporation, or a parent corporation of a subsidiary that is wound up under subsection 88(1) into the parent corporation, to be the same corporation and a continuation of each predecessor corporation to the amalgamation or the subsidiary corporation, respectively. These paragraphs are relevant for the purposes of the exemptions from the application of subsection 55(2) that are provided under subparagraphs 55(3)(*a*)(ii) and (v). These exemptions are applicable if there is not a significant increase in the total direct interest in any corporation, or in the total of all direct interests in a dividend payer, by unrelated persons.

New paragraph 55(3.01)(*h*) provides that a winding-up of a subsidiary wholly-owned corporation to which subsection 88(1) applies, or an amalgamation under subsection 87(11) of a corporation with one or more subsidiary wholly-owned corporations, is deemed not to result in a significant increase in the total direct interest, or in the total of all direct interests, in the subsidiary or subsidiaries. This amendment relates to a Department of Finance comfort letter dated April 21, 2005. The issue addressed is that the shareholder could, as a result of an amalgamation or winding-up, have a significant increase in the shareholder’s total direct interest in the continued corporation solely because the shareholder’s interest (which did not change in economic terms) went from being an indirect interest to being a direct interest on the amalgamation or winding-up.

The three amendments to subsection 55(3.01) apply in respect of dividends received after 2003.

Paragraph 55(3)(*b*) not applicable

ITA
55(3.1)

Subsection 55(3.1) of the Act sets out the circumstances in which a dividend received in the course of a butterfly reorganization to which paragraph 55(3)(*b*) applies is not excluded from the application of subsection 55(2). Specifically, a dividend will be denied the butterfly exemption where the conditions set out in any of paragraphs 55(3.1)(*a*) to (*d*) apply.

Subsection 55(3.1) is amended in three respects, consistent with Department of Finance comfort letters dated June 8, 2005 and November 26, 2004.

ITA
55(3.1)(*a*)

Paragraph 55(3.1)(*a*) of the Act provides that a dividend received in the course of a butterfly reorganization to which paragraph 55(3)(*b*) applies is not excluded from the application of subsection 55(2) if, in contemplation of and before a distribution made in the course of the reorganization in which the dividend is received, property became property of the distributing corporation, a corporation controlled by it, or of a predecessor corporation of any such corporation. This rule is subject to certain exceptions.

Paragraph 55(3.1)(*a*) is amended to provide that the paragraph does not apply to property acquired in contemplation of (and before) a reorganization described in paragraph 55(3)(*b*) by the distributing corporation if the distribution is made by a "specified corporation" as defined in subsection 55(1). In general terms, a specified corporation is a public corporation or a specified wholly-owned corporation of a public corporation, where certain conditions are met.

This amendment relates to a comfort letter dated November 26, 2004 issued by the Department of Finance. The issue that this amendment addresses is that the rules governing butterfly reorganizations mandate that each type of property owned by the distributing corporation (other than a distributing corporation that is a specified corporation) be distributed pro rata to each transferee corporation based on the transferee corporation's proportionate interest in the distributing corporation. However, in the case of a specified corporation, subsection 55(3.02) permits the distributing corporation to undertake a butterfly reorganization by making a proportionate distribution of all its property as opposed to each type of property. As a consequence, the restrictions in paragraph 55(3.1)(*a*), which protect against the alteration of types of property in anticipation of a butterfly reorganization, should not apply if the distribution is a distribution of a specified corporation.

This amendment applies in respect of dividends received after 2003.

ITA
55(3.1)(*c*)

Paragraph 55(3.1)(*c*) of the Act denies the butterfly exemption for a dividend received by a transferee corporation in circumstances where, as part of the series of transactions or events that includes the receipt of the dividend, a significant portion of the property received by the transferee corporation on a distribution becomes property of a partnership or of a person who is not related to the transferee corporation. For this purpose, certain exceptions are provided, including under clause 55(3.1)(*c*)(i)(A), which refers to property acquired as a result of a disposition in the ordinary course of business.

Clause 55(3.1)(*c*)(i)(A) is amended to include property acquired before the distribution for consideration that consists solely of money or indebtedness that is not convertible into other property. The issue that this amendment addresses is set out in the following excerpt from a Department of Finance comfort letter dated June 8, 2005:

> *You advised us that a taxable Canadian corporation ("HoIdco") has two shareholders, both of which are taxable Canadian corporations ("Xco" and "Yco"). Xco and Yco own 2/3 and 1/3, respectively, of the common shares of Holdco. The principal asset owned by Holdco is shares of a public corporation ("Pubco").*
>
> *HoIdco is proposing to implement a reorganization described in paragraph 55(3)(b) of the Act (i.e., a "butterfly reorganization"). Prior to the distribution that will occur in the course of the butterfly reorganization, Holdco intends to dispose of 1/3 of its Pubco shares either directly through the stock exchange or indirectly by disposing of the shares of a wholly-owned subsidiary corporation to which Holdco will transfer the Pubco shares. In each case, the shares will be disposed of at fair market value for consideration that consists only of money.*
>
> *Your concern is that property described in clauses 55(3.1)(c)(ii)(B) and 55(3.1)(d)(ii)(B) will be acquired as a result of the proposed disposition of the shares of Pubco. You submit that the result is anomalous and frustrates the legislative scheme in paragraphs 55(3.1)(c) and (d), particularly in view of the exclusion in clause 55(3.1)(a)(iv)(C) for property disposed of for proceeds that consist only of money or indebtedness that is not convertible into other property.*

This amendment applies in respect of dividends received after 2003.

ITA
55(3.1)(*d*)

Paragraph 55(3.1)(*d*) of the Act denies the butterfly exemption for a dividend received by the distributing corporation in circumstances where, as part of the series of transactions or events that includes the receipt of the dividend, a significant portion of the property owned by the distributing corporation immediately before it made a distribution and not disposed of by it on the distribution is acquired by a partnership or a person who is not related to the distributing corporation.

For this purpose, certain exceptions are provided, including under clause 55(3.1)(*d*)(i)(A), which refers to property acquired as a result of a disposition in the ordinary course of business. Clause 55(3.1)(*d*)(i)(A) is amended to include property acquired before the distribution for consideration that consists solely of money or indebtedness that is not convertible into other property. This amendment concerns the comfort letter dated June 8, 2005 discussed above. For further information, see the commentary on paragraph 55(3.1)(*c*).

This amendment applies in respect of dividends received after 2003.

Clause 25

Amounts to be included in income

ITA
56(1)(*a*)

Subparagraph 56(1)(*a*)(i) of the Act includes in the income of a taxpayer for a taxation year certain pension benefits received by the taxpayer in the year, with the exceptions listed in clauses 56(1)(*a*)(i)(D) to (F).

Subparagraph 56(1)(*a*)(i) is amended to add new clause 56(1)(*a*)(i)(G) to exempt from inclusion in the income of a taxpayer an amount paid out of a registered pension plan (RPP) as a refund of contributions made to the RPP where:

- the refund is described under subsection 147.1(19) of the Act (i.e., a refund of contributions made as a result of a reasonable error) or subparagraph 8502(*d*)(iii) of the *Income Tax Regulations* (i.e., a refund to avoid the revocation of registration of the RPP); and
- the amount is not deducted as an RPP contribution for the taxation year in which the refund is made or for any preceding taxation year.

For further information, see the commentary on new subsection 147.1(19) regarding refunds of contributions made to an RPP as a result of a reasonable error.

This amendment applies to contributions made on or after the later of January 1, 2014 and the day on which Royal Assent is received.

CPP/QPP and UCCB amounts for previous years

ITA
56(8)

Subsection 56(8) of the Act allows an individual to exclude from income for the taxation year of receipt certain CPP/QPP disability benefits and benefits received under the *Universal Child Care Benefit Act* that relate to one or more prior years (except where the prior year benefits are less than $300) and to pay tax on those benefits as if they had been received in the years to which they relate. The payment of tax on this basis is provided for in section 120.3.

Subsection 56(6) provides that, in certain circumstances, Universal Child Care Benefits are to be included in the income of an individual other than the recipient (i.e., the recipient’s cohabiting spouse or common-law partner). Subsection 56(8) is amended so that it also applies to such an individual.

This amendment applies to the 2006 and subsequent taxation years.

Clause 26

Refund of income payments

ITA
60(*q*)

Paragraph 60(*q*) of the Act provides a deduction for any amount repaid by a taxpayer on account of a scholarship, fellowship, bursary, research grant or prize for achievement that was included in computing the taxpayer’s income for a previous year.

Subparagraph 60(*q*)(i) is amended to also allow a deduction where the corresponding inclusion is in the taxpayer's income for the current year.

This amendment comes into force on March 1, 1994.

Clause 27

Support payments

ITA
60.001

Section 60.001 of the Act is a rule of application for former paragraph 60(*c.1*), which provided for the deductibility of certain support payments payable pursuant to orders made by a competent tribunal in accordance with the laws of a province. Section 60.001 is irrelevant in respect of orders made after 1992 as a result of the amendment of paragraph 60(*c.1*) by S.C. 1994, c. 7.

The repeal of section 60.001 applies to orders made after Royal Assent.

Clause 28

Support payments

ITA
60.1(1)

Subsection 60.1(1) of the Act provides that for the purposes of paragraph 60(*b*) and subsection 118(5), if an order or agreement provides for the payment of an amount by the taxpayer to or for the benefit of a person or children in the person's custody, the amount when payable is deemed to be payable to and receivable by the person and the amount when paid is deemed to be paid to and received by the person.

Paragraph 60(*b*) provides for the deduction of certain support amounts paid by a taxpayer to a person while the taxpayer and the person are living separate and apart. The deduction provided by paragraph 60(*b*) parallels paragraph 56(1)(*b*).

The French version of subsection 60.1(1) is amended to correct the reference to paragraph 60(*b*) and to clarify the circumstances in which the subsection applies.

This amendment comes into force on Royal Assent.

Clause 29

Support payments

ITA
60.11

Section 60.11 of the Act is a rule of application for former subparagraph 60.1(1)(*a*)(ii), which in turn applied for the purposes of the deduction of support payments under paragraph 60(*b*). Section 60.11 is irrelevant in respect of amounts paid under a decree, order or judgment made by a competent tribunal after 1992, or under a written agreement entered into after 1992, as a result of the amendment of subsection 60.1(1) by S.C. 1994, c. 7.

The repeal of section 60.11 comes into force on Royal Assent.

Clause 30

Resource expenses

ITA
66

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

Loss restriction event

ITA
66(11.4) and (11.5)

Subsection 66(11.4) of the Act applies if a corporation, or a partnership of which a corporation is a majority-interest partner, acquires a Canadian resource property or foreign resource property (subject to an exception for property transferred among affiliated persons including the corporation or partnership) within the 12-month period that ends immediately before an acquisition of control of the corporation. If the corporation was not a principal-business corporation immediately before that period, two rules apply for purposes of subsection 66(4) and sections 66.2, 66.21 and 66.4. First, if the property was disposed of and not reacquired before the acquisition of control, the property is treated as having been acquired immediately before the disposition. Second, if the first rule does not apply, the property is treated as not having been acquired until after the acquisition of control.

Subsection 66(11.4) is amended to extend its application to trusts. Specifically, the subsection applies if a taxpayer that is a corporation or trust, a partnership of which the taxpayer is a majority-interest partner or, after September 12, 2013, a trust of which the taxpayer is a majority-interest beneficiary (as defined in subsection 251.1(3)), acquires a Canadian resource property or foreign resource property within the 12-month period that ends immediately before the taxpayer is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

If a taxpayer referred to in subsection 66(11.4) is formed shortly before it became subject to a loss restriction event, the exception provided in that subsection for transfers among affiliated persons will not apply. Specifically, the acquired property will not be able to meet the test of having been held by the taxpayer or by an affiliated person throughout the relevant period. Subsection 66(11.5) ensures the appropriate result under subsection 66(11.4) in such a case. Subsection 66(11.5) treats a newly-formed corporation or trust as having been in existence from the time immediately before the relevant 12-month period to the time immediately after it was formed, and as having been affiliated during that time with the persons with whom it was affiliated from its formation until it is subject to a loss restriction event.

Subsection 66(11.5) is amended to extend its application to trusts, consequential on the extension of subsection 66(11.4) to trusts. The references in subsection (11.5) to “incorporated or otherwise formed” have been changed to “formed or created” to account for trusts.

These amendments come into force on March 21, 2013.

Loss restriction event – application of 66.7

ITA
66(11.6)

Section 66.7 of the Act provides rules (commonly known as the "successor rules") in respect of certain resource expenses. The successor rules establish the parameters within which unused resource expenses of an "original owner" may be deducted by a corporation (the successor) following an acquisition of resource properties by the successor. Specifically, a successor generally may deduct the unused resource expenses of the original owner only to the extent of the successor's income from the resource properties acquired from the original owner.

The successor rules also apply, by operation of subsection 66.7(10), to limit the deduction of a corporation's own resource expenses if there has been an acquisition of control of the corporation by a person or group of persons. Subsection 66.7(10) in effect treats the corporation as a successor that at the time of the acquisition of control acquired all its property from an original owner. As a result, the deductions otherwise available in respect of resource expenses incurred by the corporation before the acquisition of control are subject to the limitations in the successor rules.

New subsection 66(11.6) extends the rules in subsection 66.7(10) to a trust that is at a particular time subject to a loss restriction event. Under subsection 66(11.6), a trust is deemed, for the purposes of the income tax rules relating to the deduction of certain resource expenses, to be a successor corporation that acquired, at the particular time from an original owner, all of the properties held by the trust at the particular time. Under the successor rules as they apply to trusts, the trust's resources expenses from before the particular time will be deductible only against the trust's income from, or in respect of the disposition of, properties owned at the particular time. If the trust is a member of a partnership at the particular time, the trust is treated as owning a proportionate share of the partnership's resource properties and as having a specified share, determined under clause 66(11.6)(*a*)(vi)(B), of the partnership's income in respect of those properties.

A trust's ability to deduct expenses in respect of its resource properties held at the particular time it is subject to a loss restriction event is further restricted by the anti-avoidance rule contained in paragraph 66(11.6)(*b*). That rule applies if the trust acquires certain resource properties and it can reasonably be considered that one of the main purposes of the acquisition is to avoid a limitation under the successor rules on the deduction of expenses incurred by the trust. In these circumstances, the trust is deemed not to have acquired the property, with the result that no resource expense deductions are available to the trust in respect of the property.

The trust's status as a corporation under the successor rules is limited to applying those rules to the trust itself. In addition, under subparagraph 66(11.6)(*a*)(vii), a trust's unused resource expenses in respect of property that is held by the trust at the particular time it is subject to a loss restriction event cannot be, on a subsequent disposition of the property by the trust, deducted by any person.

For further information on loss restriction events, see the commentary on section 251.2.

New subsection 66(11.6) comes into force on March 21, 2013.

Expenses in the first 60 days of the year

ITA
66(12.66)(*b*)(ii)

Subsection 66(12.66) of the Act permits a corporation to renounce Canadian exploration expense (CEE) and Canadian development expense (CDE) to a flow-through shareholder within defined limits. Where the conditions described in subsection 66(12.66) are met, the corporation may renounce in January, February or March of a particular calendar year, effective as of the end of the preceding calendar year, the expenses described in subsection 66(12.66) that the corporation has incurred, or plans to incur, in the particular year. In other words, subsection 66(12.66) provides a “look-back” period of one year.

Subparagraph 66(12.66)(*b*)(ii) is amended to add references to paragraphs (*g.2*), (*g.3*) and (*g.4*) of the definition of CEE in subsection 66.1(6). Consistent with the dates of introduction for these paragraphs, this amendment comes into force on March 22, 2011 with respect to the reference to paragraph (*g.2*) and on March 21, 2013 with respect to the reference to paragraphs (*g.3*) and (*g.4*).

Clause 31

Canadian exploration expense

ITA
66.1

Section 66.1 of the Act provides rules relating to the deduction of “Canadian exploration expense” (CEE), defined in subsection 66.1(6). Specifically, the deduction of CEE is provided for through the concept of “cumulative Canadian exploration expense” (as defined in subsection 66.1(6)) and deductions under subsections 66.1(2) and (3) with respect to cumulative Canadian exploration expense.

Definitions

ITA
66.1(6)

Subsection 66.1(6) of the Act provides several definitions for the purposes of section 66.1, such as Canadian exploration expense, cumulative Canadian exploration expense, and Canadian renewable and conservation expense. Canadian exploration expense of a taxpayer includes any Canadian renewable and conservation expense incurred by the taxpayer.

“Canadian exploration expense”

The definition “Canadian exploration expense” (CEE) in subsection 66.1(6) defines oil, gas, mining, and Canadian renewable and conservation expenses that qualify for treatment as CEE, which expenses are fully deductible in the taxation year incurred or in a future taxation year.

The definition of CEE is amended to implement the transition from CEE to Canadian development expense (CDE) for expenses incurred after March 20, 2013 for the purpose of bringing a new mine in a mineral resource in Canada (other than an oil sands mine) into production in reasonable commercial quantities (i.e., the expenses described in paragraph (*g*) of the definition of CEE, which are referred to in this commentary as “eligible pre-production mine development expenses”). The definition of CEE is amended in four respects.

First, paragraph (*g*) of the definition of CEE is amended to ensure that only eligible pre-production mine development expenses incurred before March 21, 2013 are treated as CEE.

Second, new paragraph (*g.3*) is added to the definition of CEE to provide for grandfathering of CEE treatment for two types of eligible pre-production mine development expenses that are incurred before 2017. In particular, subparagraph (*g.3*)(i) ensures that eligible pre-production mine development expenses that are incurred under a written agreement entered into by a taxpayer before March 21, 2013 will continue to be treated as CEE. In addition, subparagraph (*g.3*)(ii) provides that eligible pre-production mine development expenses incurred (before 2017) for the development of a new mine will continue to be treated as CEE, if either the construction, or the engineering and design work for the construction, of the new mine was started by, or on behalf of, the taxpayer before March 21, 2013. The evidence of the commencement before March 21, 2013 of the engineering and design work for the construction of the new mine must be in writing. For these purposes, the following activities are not considered construction or the engineering and design work for the construction of the mine:

- obtaining permits or regulatory approvals;
- conducting environmental assessments, community consultations or impact benefit studies; and
- any other similar activities.

Third, new paragraph (*g.4*) is added to the definition of CEE to phase in the transition from CEE to CDE of the eligible pre-production mine development expenses incurred after March 20, 2013. A portion of the eligible pre-production mine development expenses, if incurred by a taxpayer before 2018, will continue to qualify as a CEE of the taxpayer based on the following rates: 100% of the expense in 2013 and 2014, 80% of the expense in 2015, 60% of the expense in 2016, and 30% of the expense in 2017. The remainder of the expense will qualify as a CDE of the taxpayer. Therefore, a taxpayer may allocate eligible pre-production mine development expenses proportionally between two resource expense categories – CEE and CDE – based on the year in which the expense is incurred.

Fourth, paragraph (*h*) of the definition CEE is amended to add references to paragraphs (*g.2*), (*g.3*) and (*g.4*). Consistent with the dates of introduction for these paragraphs, this amendment comes into force on March 22, 2011 with respect to the reference to paragraph (*g.2*) and on March 21, 2013 with respect to the reference to paragraphs (*g.3*) and (*g.4*).

“Canadian renewable and conservation expense”

The definition “Canadian renewable and conservation expense” has the meaning assigned by section 1219 of the *Income Tax Regulations*. In this regard, the *Technical Guide to Canadian Renewable and Conservation Expenses (CRCE)* published by the Department of Natural Resources applies conclusively with respect to engineering and scientific matters in the determination of whether an expense meets the criteria set out in section 1219 of the *Income Tax Regulations*.

The definition is amended to clarify that in respect of a prescribed energy conservation property the *Technical Guide to Canadian Renewable and Conservation Expenses (CRCE)* applies only to establish criteria as to whether or not expenses are Canadian renewable and conservation expenses.

This amendment comes into force on December 21, 2012.

“eligible oil sands mine development expense”

The definition “eligible oil sands mine development expense” is important in determining the proportion of oil sands mine development expenses incurred over the calendar years 2011-2015

transition period that is treated as CEE. A taxpayer may allocate pre-production oil sands mine development expense incurred after March 21, 2011 and before 2016, proportionally to the two resource expense categories based on the year in which the expense is incurred; respectively as 100% CEE in 2011 and 2012, 80% CEE and 20% CDE in 2013, 60% CEE and 40% CDE in 2014, and 30% CEE and 70% CDE in 2015.

The definition is amended consequential on the amendments to paragraph (*g*) of the definition CEE to phase in the transition from CEE to CDE for eligible pre-production mine development expenses incurred after March 20, 2013. This amendment ensures that the appropriate portion of the eligible oil sands mine development expenses incurred after March 20, 2013 will continue to be treated as CEE.

This amendment comes into force on March 21, 2013.

"specified oil sands mine development expense"

A "specified oil sands mine development expense" means an expense incurred by a taxpayer after March 21, 2011 and before 2015, to achieve completion of a specified oil sands mine development project of the taxpayer, that would be a CEE described in paragraph (*g*) of the definition of CEE if that paragraph were read without reference to the words "other than a bituminous sands deposit or an oil shale deposit".

The definition is amended to provide that, for the purposes of specified oil sands mine development expense, paragraph (*g*) of the definition of CEE is to be read without reference to the phrase "before March 21, 2013". This amendment ensures that specified oil sands mine development expense incurred after March 20, 2013 will continue to be treated as CEE.

This amendment comes into force on March 21, 2013.

Clause 32

Canadian development expense

ITA
66.2

Section 66.2 of the Act provides rules relating to the deduction of "Canadian development expense", as defined in subsection 66.2(5).

Definitions

ITA
66.2(5)

Subsection 66.2(5) of the Act contains the definitions "Canadian development expense" and "cumulative Canadian development expense".

"Canadian development expense"

New paragraph (*c.2*) is added to the definition "Canadian development expense" (CDE) to include any expense incurred in bringing a new mine in a mineral resource in Canada (other than an oil sands mine) into production in reasonable commercial quantities, including an expense for clearing the land, removing overburden and stripping, sinking a mine shaft or constructing an adit or other underground entry. Paragraph (*c.2*) does not include an expense or any portion of an expense described in paragraphs (*g.3*) or (*g.4*) of the definition of CEE.

This amendment comes into force on March 21, 2013.

Clause 33

Exemption for expenses for food, etc.

ITA
67.1(2)

Subsection 67.1(1) of the Act provides a general limitation on the amount that may be deducted in respect of the human consumption of food or beverages or the enjoyment of entertainment, limiting an otherwise deductible amount to 50% of the expense. Subparagraph 67.1(2)(*e*)(iii) provides that meal and entertainment expenses are exempt from the application of subsection 67.1(1) if they are paid or payable in respect of the taxpayer's duties performed at a special work site in Canada that is at least 30 kilometres from the nearest boundary of any urban area that has a population of at least 40,000 people. "Urban area" is defined by Statistics Canada in the *Census Dictionary*.

Subparagraph 67.1(2)(*e*)(iii) is amended to replace the term "urban area" with "population centre" as a result of the adoption by Statistics Canada of the term "population centre" in place of "urban area".

This amendment applies to the 2013 and subsequent taxation years.

Clause 34

Death of a taxpayer

ITA
70

Section 70 of the Act provides certain rules that apply on the death of a taxpayer.

ITA
70(5.31)

Subsection 70(5) of the Act provides for the deemed disposition of a taxpayer's capital property on the taxpayer's death for proceeds equal to the property's fair market value immediately before the death. A special rule in subsection 70(5.3) applies where a life insurance policy is relevant to determining the fair market value of a property deemed disposed of under subsection 70(5) – for example, where the deceased taxpayer's property includes shares of the capital stock of a corporation and the corporation is the owner of a life insurance policy under which the taxpayer's life was insured. In this case, the fair market value of the property is determined under subsection 70(5.3) as if the value of the policy were the policy's cash surrender value immediately before the taxpayer's death. This rule also applies in respect of deemed dispositions under subsection 104(4) of trust property on the death of a trust beneficiary and under section 128.1 on the change of residence of a taxpayer.

New subsection 70(5.31) provides a similar special valuation rule for the purposes of determining the fair market value of property deemed disposed of, due to the death of a taxpayer, under subsections 70(5) and 104(4). The rule applies where the deceased taxpayer's life was insured under an LIA policy and an annuity contract issued in respect of an LIA policy is relevant to determining the fair market value of the property that is deemed to have been disposed of. In this case, the fair market value of the annuity contract is, in effect, deemed to be the total of the premiums paid under the annuity contract until the time immediately before the taxpayer's death.

For further information on LIA policies, see the commentary on the definition "LIA policy" in subsection 248(1).

This amendment applies to taxation years that end after March 20, 2013.

Clause 35

Revocable trusts and exceptions

ITA
75(2) and (3)

Subsection 75(2) of the Act generally provides for the attribution to a person resident in Canada of income and losses derived from certain trust property where the property was received by the trust from the person and can revert to the person (or pass to other persons determined by that person). Subsection 75(3) exempts property held by certain trusts from this attribution rule.

Subsection 75(2) is amended to provide that a trust must be resident in Canada in order for the subsection to apply in respect of property held by the trust. A related amendment to paragraph 94(4)(*h*) provides that paragraph 94(3)(*a*) will not apply for the purpose of determining whether subsection 75(2) applies. As a consequence, subsection 75(2) will apply only in respect of property held by a trust that is resident in Canada (determined without regard to the deemed residence rule in subsection 94(3)).

Consequential on the amendment to subsection 75(2), subsection 75(3) is amended to replace its paragraphs (*c*) to (*c.3*) with new paragraph (*c*). The references in paragraphs (*c*) to (*c.3*) to non-resident trusts, and to an electing contributor (as defined in subsection 94(1)) in respect of a non-resident trust, are unnecessary because amended subsection 75(2) will not apply in respect of property held by a non-resident trust. New paragraph 75(3)(*c*) replaces existing paragraph 75(3)(*c.1*) – subsection 75(2) will continue not to apply in respect of property held by a qualifying environmental trust.

For further information, see the commentary on subsections 94(8.1) and (8.2) and paragraph 94(4)(*h*).

These amendments apply to taxation years that end after March 20, 2013.

Clause 36

Debt forgiveness

ITA
80

Section 80 of the Act contains rules that apply in respect of the forgiveness of certain debt obligations.

Definitions

ITA
80(1)

Subsection 80(1) of the Act contains definitions that apply for purposes of section 80 and certain related rules.

"relevant loss balance"

Under subsections 80(3) and (4), a forgiven amount in respect of debt issued by a debtor is applied at the time that the debt is settled to reduce the debtor's loss balances (i.e., loss carry over amounts). The amount by which a loss for a year may be reduced under those subsections is limited to the relevant loss balance for the relevant obligation and in respect of that loss. The relevant loss balance of a

corporate debtor for an obligation and in respect of a net capital loss, non-capital loss, farm loss or restricted farm loss for a previous year is deemed to be nil after an acquisition of control of the debtor that occurred after that previous year unless the obligation was issued before, and not in contemplation of, that acquisition of control, or all or substantially all of the proceeds from issuing that obligation were (directly or indirectly) used to refinance a qualifying obligation.

The definition "relevant loss balance" is amended to extend to trusts, by referring to a taxpayer that is subject to a loss restriction event, the rule that deems the relevant loss balance of certain obligations to be nil. For further information, see the commentary on sections 111 and 251.2.

This amendment comes into force on March 21, 2013.

"unrecognized loss"

Subsection 80(13) includes an amount in computing the income of a debtor for the taxation year in respect of the remaining unapplied portion of the forgiven amount in respect of a commercial obligation settled in the year. The amount of a debtor's "unrecognized loss" (as defined in subsection 80(1)) can be used to offset the amount otherwise included under subsection 80(13) in computing the debtor's income. Subject to exceptions where there has been an acquisition of control of the debtor, a debtor's unrecognized loss from the disposition of property is equal to the total capital losses from the disposition of the property that are denied under subparagraph 40(2)(*g*)(ii). In the case of a corporate debtor control of which was acquired after the unrecognized loss was realized, the unrecognized loss at any later time is deemed to be nil, unless the obligation was issued before, and not in contemplation of, that acquisition of control, or all or substantially all of the proceeds from issuing that obligation were (directly or indirectly) used to refinance a qualifying obligation.

The definition "unrecognized loss" is amended to extend to trusts, by referring to a taxpayer that is subject to a loss restriction event. For further information, see the commentary on sections 111 and 251.2.

This amendment comes into force on March 21, 2013.

Members of partnerships

ITA
80(15)(*c*)

Under subsection 80(15) of the Act, a member of a partnership is allowed a deduction not exceeding the amount that would, if the partnership had designated amounts to the maximum extent permitted under subsections 80(5) to (10) in respect of the forgiven amount of an obligation issued by it, have been included as the member's share of any income resulting from the application of subsection 80(13). (Subsection 80(13) includes an amount in computing the income of a debtor for the taxation year in respect of the remaining unapplied portion of the forgiven amount in respect of a commercial obligation settled in the year.) For this purpose, income resulting from subsection 80(13) is considered to arise from a separate source so that current year partnership expenses do not have any impact on the computation of the deduction. However, if a member of a partnership does deduct such an amount, the member is deemed to have issued a commercial obligation that was settled at the end of the fiscal period of the partnership in which the partnership's obligation was settled. The amount of such deduction claimed by the partner is treated as if it were the forgiven amount in respect of the deemed obligation.

Under subsection 80(15), a deemed obligation is generally treated as having been issued at the same time and in the same circumstances as the partnership obligation that gives rise to the application of subsection 80(13). In addition, for the purpose of applying subsection 80(13) in respect of the deemed obligation, the source in connection with which the deemed obligation was issued is deemed to be the source in connection with which the partnership obligation was issued.

If the member is a corporation the control of which was acquired after the time that an obligation is deemed by subsection 80(15) to be issued and before the corporation became a member of the partnership, the obligation is considered under subparagraph 80(15)(*c*)(iv) to have been issued after the time of the acquisition of control (or after a later acquisition of control, where relevant). As a consequence, the corporation is not able to apply the deemed forgiven amount under subsection 80(15) against losses arising before an acquisition of control in these circumstances.

Subparagraph 80(15)(*c*)(iv) is amended to extend its application to trusts. Specifically, the amended subparagraph applies if the relevant partnership member is a taxpayer that is a trust or corporation that was subject to a loss restriction event at the relevant time. The deemed forgiven amount under subsection 80(15) cannot be applied against the taxpayer's losses arising before the loss restriction event.

This amendment comes into force on March 21, 2013.

Clause 37

Agreement respecting transfer of forgiven amount

ITA
80.04

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

ITA
80.04(4)(*h*)

Paragraphs 80.04(4)(*e*) to (*j*) of the Act set out the rules that apply where a debtor and an eligible transferee make a valid election in respect of a particular debt for which a forgiven amount arises under section 80 on settlement of the particular debt. Generally, the transferee is deemed to have issued a commercial debt obligation that was issued at the same time as and in similar circumstances, and also settled at the same time as, the particular debt. However, under paragraph 80.04(4)(*h*), if the transferee is a corporation the control of which was acquired after the time of issue of the deemed obligation and the transferee corporation and the debtor were not related to each other immediately before that acquisition of control, the deemed obligation is treated as having been issued after the acquisition of control. As a result, the transferee is not able to apply the forgiven amount against losses arising before the acquisition of control.

Paragraph 80.04(4)(*h*) is amended to extend to trusts, by referring to a taxpayer that is subject to a loss restriction event. For further information, see the commentary on sections 111 and 251.2.

This amendment comes into force on March 21, 2013.

Clause 38

Synthetic disposition – deemed disposition

ITA
80.6

New subsection 80.6(1) of the Act is introduced to generally provide that a taxpayer who owns a property and who enters into a synthetic disposition arrangement in respect of it is deemed to have disposed of the property for proceeds equal to its fair market value and to have immediately reacquired the property at that fair market value. The subsection ensures that taxpayers cannot defer the tax consequences of disposing of a property by entering into a synthetic disposition arrangement.

The deemed disposition under subsection 80.6(1) occurs at the beginning of the synthetic disposition period in respect of the synthetic disposition arrangement. The new terms “synthetic disposition arrangement” and “synthetic disposition period” are defined in subsection 248(1).

Subsection 80.6(1) applies to synthetic disposition arrangements with a synthetic disposition period of at least one year. The synthetic disposition period is essentially the period for which all or substantially all the taxpayer’s risk of loss and opportunity for gain or profit in respect of a property have been eliminated.

Subsection 80.6(2) sets out a number of exceptions to the deemed disposition rule in subsection 80.6(1). Paragraph 80.6(2)(*a*) provides that subsection 80.6(1) does not apply unless the deemed disposition would result in the realization of a capital gain or in an income inclusion. The deemed disposition therefore occurs in circumstances where there is the potential for a deferral of tax. Paragraph 80.6(2)(*b*) provides that subsection 80.6(1) does not apply in respect of mark-to-market property, in which case there is an annual realization event, making a deemed disposition in the year unnecessary. Paragraph 80.6(2)(*c*) provides that subsection 80.6(1) does not apply to a synthetic disposition arrangement that is a lease of tangible property, or for civil law purposes, corporeal property. It is not intended that the synthetic disposition rule displace the existing tax rules with respect to these leases.

Paragraphs 80.6(2)(*d*) provides that subsection 80.6(1) does not apply to an exchange of property to which subsection 51(1) applies. Subsection 51(1) generally permits a tax-deferred transfer of property where a taxpayer, pursuant to a right of conversion, exchanges capital property that is a share, bond, debenture or note of a corporation for other capital property that is a share of the capital stock of the corporation. Paragraph 80.6(2)(*e*) provides that subsection 80.6(1) does not apply if the property is otherwise disposed of, as part of the arrangement, within one year after the day on which the synthetic disposition period of the arrangement begins. Subsection 51(1) rollovers do not fall within the ambit of paragraph 80.6(2)(*e*) because there is no deemed disposition under subsection 51(1). Several other provisions of the Act allow for the tax-deferred transfer of property in certain circumstances (e.g., subsections 85(1), 85.1(1) and 86(1)) and in those cases paragraph 80.6(2)(*e*) would apply.

Example

John owns shares of ABC Co. that have an adjusted cost base of $1 million and a fair market value of $10 million. If John sold the shares outright, he would realize a $9 million capital gain. John, however, wants to sell the shares without any immediate tax consequences. In order to effectively sell the shares while deferring tax on the accrued capital gain, John enters into a synthetic disposition arrangement.

John receives a five-year loan for $10 million from a purchaser (with interest of $2 million payable in five years). Under the arrangement, John obtains a right to settle the loan (including accrued interest) in five years by transferring the ABC Co. shares to the purchaser and the purchaser obtains a right to acquire the shares from John in five years for $12 million. As a result, John has eliminated his risk of loss and opportunity for gain or profit in respect of the ABC Co. shares. If the value of the shares is less than $12 million in five years, John would settle the loan by transferring ownership of the shares to the purchaser. If the value of the shares is greater than $12 million in five years, the purchaser would exercise the right to acquire the shares for $12 million.

Under section 80.6, John will be deemed to have disposed of the ABC Co. shares at their fair market value of $10 million when he enters into the arrangement and will be deemed to have immediately reacquired the shares at a cost of $10 million. As a result, John will have an immediate capital gain of $9 million.

In five years, John will dispose of the shares for proceeds of $12 million (either to settle the $12 million debt or to settle the purchaser's right to acquire the shares for $12 million), which will exceed the $10 million adjusted cost base of the ABC Co. shares to John at that time. As a result of the application of new paragraph 12(1)(z.7), John will have a $2 million income inclusion and no additional capital gain will result from the final disposition.

Section 80.6 applies to agreements and arrangements entered into after March 20, 2013. It also applies to an agreement or arrangement entered into before March 21, 2013, the term of which is extended after March 20, 2013, and it applies to the agreement or arrangement as if the agreement or arrangement were entered into at the time of the extension.

Clause 39

Rules applicable to amalgamations

ITA
87

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

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

Paragraph 87(2)(*g.1*) of the Act provides that, for certain purposes, a new corporation formed as a result of an amalgamation is to be treated as a continuation of each predecessor corporation. Paragraph 87(2)(*g.1*) is amended consequential on the introduction of the new corporate loss trading rules in section 256.1 to add a reference to section 256.1.

By reason of paragraph 88(1)(*e.2*), which refers to paragraph 87(2)(*g.1*), the provision also applies for the purposes of section 256.1 to a parent in respect of a wholly-owned subsidiary that has been wound up under subsection 88(1).

This amendment comes into force on March 21, 2013.

Refundable investment tax credit and balance-due day

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

Paragraph 87(2)(*oo.1*) of the Act applies for the purposes of the definition "qualifying corporation" in subsection 127.1(2) and for the one-month extension of the corporation's balance-due day under subparagraph (*d*)(i) of the definition "balance-due day" in subsection 248(1). The definition "qualifying corporation" is relevant for determining the eligibility for refundable investment tax credits under section 127.1 of a new corporation formed on an amalgamation.

Paragraph 87(2)(*oo.1*) provides that a new corporation's taxable income for a specified previous taxation year is deemed to be the sum of its predecessor corporations' taxable incomes for taxation years that end as a consequence of the amalgamation. The paragraph also provides a similar rule for the computation of the new corporation's business limit for the specified previous taxation year. This specified previous taxation year is consistent with the taxation year specified under the definition "qualifying corporation" in subsection 127.1(2) and subparagraph (*d*)(i) of the definition "balance-due day" in subsection 248(1).

However, the qualifying income limit of a corporation is also relevant for the purposes of the definition "qualifying corporation" in subsection 127.1(2). Therefore, new subparagraph 87(2)(*oo.1*)(iv) is added to provide that a new corporation's qualifying income limit for a specified previous taxation year is deemed to be the sum of its predecessor corporations' qualifying income limits for taxation years that end as a consequence of the amalgamation.

Consistent with the application date of the definition "qualifying income limit" in subsection 127.1(2), this amendment applies to amalgamations that occur after February 25, 2008.

Clause 40

Winding-up

ITA
88

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

ITA
88(1)

Subsection 88(1) of the Act provides rules that apply in certain circumstances where a taxable Canadian corporation (the subsidiary) has been wound-up into its parent corporation. These rules also apply in certain circumstances when a parent and a subsidiary are merged by way of an amalgamation to which subsection 87(11) applies.

Paragraphs 88(1)(*c.2*) to (*c.4*) are amended to give effect to certain Department of Finance comfort letters issued since 2001. These comfort letters indicated a willingness to recommend to the Minister of Finance certain technical changes to subsection 88(1) that are consistent with the tax policy underlying the subsection. In addition, a change is made in respect of the calculation in paragraph 88(1)(*d*) of the amount by which the parent may increase or "bump" the adjusted cost base (ACB) of certain capital property acquired by it on the winding-up of its subsidiary.

ITA
88(1)(*c.2*)(i)

Subparagraph 88(1)(*c.2*)(i) of the Act defines "specified person" as the parent corporation and each person related (other than because of paragraph 251(5)(*b*)) to the parent. The definition "specified person" is relevant for the purposes of paragraph 88(1)(*c*) in that a specified person may acquire property distributed to the parent on the winding-up of the subsidiary, or property substituted for such property, without engaging the bump denial rule in subparagraph 88(1)(*c*)(vi).

The definition "specified person" in subparagraph 88(1)(*c.2*)(i) is amended in three respects. First, the definition "specified person" is amended to include persons who would be related to the parent in two circumstances. In general terms, if an individual dies, the individual's children will be considered to be related to:

- the individual's surviving brothers and sisters (i.e., their uncles and aunts); and
- each child of a deceased brother or sister of the individual (i.e., certain first cousins).

The issue that this amendment addresses is set out in the following example:

> *Individual X, who was a resident of Canada, died owning all the shares of a taxable Canadian corporation (Xco). Each of X's surviving children is entitled to an equal percentage interest in X's Estate. However, one of X's children (Z) predeceased X and, as a result, the share of X's Estate that would have devolved to Z instead devolve upon trusts for the children of Z (i.e., trusts for the grandchildren of X through Z).*
>
> *As a consequence of the death of X, the voting shares of Xco are acquired by a trust, the beneficiaries of which are the beneficiaries of X's Estate. The trust and the Estate propose to transfer the remaining shares of Xco to a newly incorporated taxable Canadian corporation (Newco). The trust would take back voting shares of Newco and the Estate would take back non-voting shares. Newco and Xco would then enter into a vertical amalgamation as described in subsection 87(11) to create "Amalco". On the amalgamation, the shares of Newco would be converted into shares of Amalco. The Estate would then distribute the non-voting shares of Amalco to the children of X and to the trusts for the grandchildren of X as provided under X's Will.*
>
> *However, the grandchildren of X through Z are not "specified persons" since they are not considered to be related to the surviving children of X (that is, to their uncles and aunts through X) for the purposes of the Act. Consequently, the grandchildren through Z cannot be considered to be part of the related group that would control Newco.*

If more than one of X's children predeceased X and X's children had children, there would be cousins who would not be related to each other for the purposes of the Act and they would not be part of the related group that would control Newco. The amendment also addresses this possibility. However, the amendment does not accommodate the situation where at the time of X's death shares were inherited by grandchildren in circumstances where their parents (the children of the deceased) were alive at the time of the death.

Second, the definition "specified person" in subparagraph 88(1)(*c.2*)(i) is amended to allow a person to be a specified person before the incorporation of the parent corporation (see new clause 88(1)(*c.2*)(i)(C)). The issue that this amendment addresses is set out in the following excerpt from a Department of Finance comfort letter dated February 23, 2007:

> *Prior to the incorporation of the parent corporation ("Parent"), a taxable Canadian corporation ("Grandparent") will acquire common shares of the subsidiary corporation ("Subco") from an arm's length person. Grandparent will acquire sufficient common shares of Subco to become a specified shareholder of Subco but not enough to acquire control of Subco. To fund the acquisition of those Subco common shares, Grandparent will issue shares and debt to a corporation that is related to it ("Related Corporation"). Grandparent will then cause the Parent to be incorporated and, following the incorporation, Parent will acquire the remaining common shares of Subco from arm's length persons, thereby acquiring control of Subco. Grandparent will transfer its Subco common shares to Parent such that, after the transfer, Subco is a wholly-owned subsidiary of Parent. As a final step, Parent would like to wind-up Subco and to increase (i.e., bump) the adjusted cost base of certain non-depreciable capital property of Subco to be acquired by it on the winding up as provided in paragraphs 88(1)(c) and (d) of the Act.*
>
> *In the circumstances described above, the Related Corporation is a specified shareholder of Subco that will acquire substituted property (shares and debt of the Grandparent) as part of the series of transactions or events that includes the winding-up of Subco. Therefore, the bump denial rule in paragraph 88(1)(c)(vi) of the Act will apply unless the Related Corporation is considered to be a specified person. In this respect, you note that subparagraph 88(1)(c.2)(i) defines "specified person" at any time to mean the parent and each person related to the parent at that time. Accordingly, you are concerned that the Related Corporation may not be a specified person solely because, at the time it acquired the shares and debt of the Grandparent, Parent had not yet been incorporated.*

Third, the definition "specified person" in paragraph 88(1)(*c.2*) is amended to place some of the text currently in subparagraph 88(1)(*c.2*)(i), which relates to an anti-avoidance rule, in new subparagraph 88(1)(*c.2*)(i.1) and by making changes consequential on the above mentioned amendments.

These amendments apply to windings-up that begin, and amalgamations that occur, after 2001.

ITA
88(1)(*c.2*)(iii)(A.1) and (A.2)

Subparagraph 88(1)(*c.2*)(iii) of the Act provides two rules that apply in determining if a person is a specified shareholder of a corporation for the purposes of paragraph 88(1)(*c.2*) and subparagraph 88(1)(*c*)(vi). The first of these rules is that a reference in the definition "specified shareholder" in subsection 248(1) to "the issued shares of any class of the capital stock of the corporation or of any other corporation that is related to the corporation" is to be read as "the issued shares of any class (other than a specified class) of capital stock of the corporation or of any other corporation that is related to the corporation and that has a significant direct or indirect interest in any issued shares of the capital stock of the corporation". The second rule deems a corporation not to be a specified shareholder of itself.

Subparagraph 88(1)(*c.2*)(iii) is amended to add two new rules. New clause 88(1)(*c.2*)(iii)(A.1) provides that a corporation controlled by another corporation is deemed not to own any shares of the capital stock of the other corporation if the corporation does not have a direct or indirect interest in any shares of the capital stock of the other corporation. The issue that this amendment addresses is set out in the following excerpt from a Department of Finance comfort letter dated August 13, 2007:

1. *Vco is a taxable Canadian corporation that controls Target, another taxable Canadian corporation. Target owns all the shares of Subco and Sellco 1. Subco owns all the shares of Sellco 2.*
2. *Aco is a taxable Canadian corporation that deals at arm's length with Vco and Target.*
3. *Pco is a taxable Canadian corporation that is controlled by another corporation (Pco Holdings). Pco and Pco Holdings deal at arm's length with Vco, Target and Aco.*
4. *Aco incorporates a wholly-owned subsidiary (A sub) which acquires all the Target shares for cash.*
5. *Target is wound up into (or amalgamated with) A sub with the view to increasing the tax cost of the shares of Subco and Sellco 1, as provided by paragraphs 88(1)(c) and (d) of the Act.*
6. *Subco is then wound up into (or amalgamated with) A sub (or its successor) with a view to increasing the tax cost of the shares of Sellco 2, as provided by paragraphs 88(1)(c) and (d) of the Act.*
7. *Pco purchases the shares of Sellco 1 and Sellco 2 from A sub (or its successor) for cash.*

Your concern is that subparagraph 88(1)(c)(vi) would preclude the increase in the cost of the shares of Subco and Sellco 1 on the winding-up (or amalgamation) of Target, as described in paragraph 5 above, and the increase in the cost of the shares of Sellco 2 on the winding-up (or amalgamation) of Subco, as described in paragraph 6 above.

Subparagraph 88(1)(c)(vi) operates to deny the increase in the cost of non-depreciable capital property distributed on the winding-up of a subsidiary if the distributed property or property substituted for the distributed property is acquired by a person or persons described in subclauses 88(1)(c)(vi)(B)(I) to (III). The purpose of the subparagraph is to deny that increase where one or more persons who had a significant interest in the subsidiary before the parent last acquired control of the subsidiary acquire a significant interest in the property, either directly or indirectly, as part of the series of transactions or events that includes the winding-up.

Your particular concern involves the inclusion in subclause 88(1)(c)(vi)(B)(III) of a corporation (other than a specified person or the subsidiary) of which a specified shareholder of the subsidiary is a specified shareholder. In your view, Pco would be a corporation described in this subclause in respect of the winding-up of Target and Subco because each of Sellco 1 and Sellco 2 will be a specified shareholder of Target and Subco prior to the acquisition of control of Target by Aco and will be a specified shareholder of Pco after Pco acquires the shares of Sellco 1 and Sellco 2. The reason that Sellco 1 and 2 will be specified shareholders of Target, Subco and Pco, is that each of Sellco 1 and Sellco 2 is deemed to own the shares of Target and Subco owned by Vco and, following the acquisition of the shares of Sellco 1 and Sellco 2 by Pco, each is deemed to own the shares of Pco owned by Pco Holdings (see, in this respect, paragraph (a) of the definition "specified shareholder" in subsection 248(1)).

You submit that the denial of the cost base increase in these circumstances is contrary to the policy underlying subparagraph 88(1)(c)(vi). This provision is not intended to deny the cost

base increase where the purchaser (in this case, Pco) is not a person described in subclauses 88(1)(c)(vi)(B)(I) to (III) prior to the acquisition of control of the subsidiary. In this respect, you note that Pco only becomes a person described in subclause 88(1)(c)(vi)(B)(III) because of the acquisition of the shares of Sellco 1 and Sellco 2. In the absence of this acquisition, Pco would not be a person described in subclause 88(1)(c)(vi)(B)(III).

New subclause 88(1)(*c.2*)(iii)(A.2) provides that the definition "specified shareholder" in subsection 248(1) is to be read without reference to its paragraph (*a*) in respect of any share of the capital stock of the subsidiary that the person would, but for clause 88(1)(*c.2*)(iii)(A.2), be deemed to own solely because the person has a right described in paragraph 251(5)(*b*) to acquire shares of the capital stock of a corporation that

- is controlled by the subsidiary referred to in subsection 88(1), and
- does not have a direct or indirect interest in any of the shares of the capital stock of the subsidiary.

The issue that this amendment addresses is set out in the following excerpt from a Department of Finance comfort letter dated August 13, 2004:

Your concern relates to a series of proposed transactions wherein a taxable Canadian corporation ("Bidco") will acquire control of another taxable Canadian corporation ("Subco") followed by a winding up of Subco into Bidco. Prior to the acquisition of control, Holdco will own all of the shares of Subco and Subco will own all the shares of another corporation ("Sellco"). As a condition of the sale of the Subco shares by Holdco to Bidco, Holdco and Subco/Bidco will enter into an agreement to sell ("purchase agreement") the shares of Sellco to an arm's length purchaser ("Pco"), which sale will occur shortly after the winding up of Subco. Prior to entering into the purchase agreement, Pco will not be a specified shareholder of Subco.

More specifically, you are concerned that the right to acquire the shares of Sellco under the purchase agreement would result in Pco being a specified shareholder of Subco, although Pco does not have, nor does it intend to acquire, any direct or indirect interest in the shares of Subco, Holdco or Bidco. Your concern relates to the application of the deeming rules in subsections 251(2), (3) and (5) combined with the definition of "specified shareholder" in subsection 248(1) of the Act.

In the circumstances described above, paragraph 251(5)(b) of the Act would deem Pco, for the purpose of subsection 251(2), to be in the same position in relation to the control of Sellco as if it owned the shares of Sellco. As a result, Pco would be related to Sellco after entering into the purchase agreement. As Pco and Holdco would be related to the same corporation, they would be deemed by subsection 251(3) to be related to each other. Under the definition of "specified shareholder", Pco would be treated as owning all the shares of Subco owned by Holdco and, therefore, would be a specified shareholder of Subco before control of Subco is acquired by Bidco. Since Pco would be a specified shareholder of Subco and, since Pco will acquire the shares of Sellco as part of the series of transactions that includes the winding up of Subco, Bidco would be precluded from obtaining a bump in the adjusted cost base of the shares of Sellco acquired on the winding up of Subco.

We agree that where a person has a right to acquire a share of a corporation (the "downstream corporation") controlled by another corporation (the "upstream corporation")

> *and the downstream corporation does not have a direct or indirect interest in any of the issued shares of the upstream corporation, the right should not, in and of itself, result in the person becoming a specified shareholder of the upstream corporation for the purpose of subparagraph 88(1)(c)(vi) of the Act. Accordingly, we are prepared to recommend to the Minister that paragraph 88(1)(c.2) of the Act be amended to exclude a right to acquire shares of a downstream corporation from being considered in determining if a person is a specified shareholder of the upstream corporation in circumstances where the downstream corporation does not have a direct or indirect interest in any of the issued shares of the upstream corporation.*

These amendments apply to windings-up that begin, and amalgamations that occur, after 2001.

ITA
88(1)(*c.2*)(iv)

New subparagraph 88(1)(*c.2*)(iv) of the Act is introduced to provide that property distributed to the parent on a winding-up to which subsection 88(1) applies is deemed not to be acquired by a person if the person acquired the property before the acquisition of control referred to in clause 88(1)(*c*)(iv)(A) and the property is not owned by the person at any time after that acquisition of control. The issue that this amendment addresses is set out in the following excerpt from a Department of Finance comfort letter dated September 1, 2006:

> *Where subsection 88(1) of the Act applies, the parent corporation may elect to increase the cost of capital property (other than ineligible property) distributed on the winding-up within the limits set out in that subsection. Capital property will be ineligible property if, among other things, a person described in any of subclauses 88(1)(c)(vi)(B)(I) to (III) (a "restricted person") acquires, as part of the series of transactions or events that includes the winding-up, property distributed to the parent on the winding-up or property substituted for such property.*
>
> *Your concern relates to a series of proposed transactions in which a restricted person will acquire property to be distributed to the parent on the winding up; however, the restricted person will not own the property at any time after the acquisition of control of the subsidiary. You note that subparagraph 88(1)(c.3)(iv) of the Act deems property not to be property substituted for the property distributed on the winding-up if it is not owned by a restricted person at any time after the acquisition of control of the subsidiary. However, there is no similar provision dealing with the acquisition of property distributed to the parent on the winding-up. Accordingly, the acquired property will be ineligible property.*
>
> *We agree that ineligible property should not include property distributed to the parent on the winding-up of the subsidiary if a restricted person does not own the property at any time after the acquisition of control of the subsidiary.*

This amendment applies to windings-up that begin, and amalgamations that occur, after 2001.

ITA
88(1)(*c.3*)(i)

Paragraph 88(1)(*c.3*) of the Act provides that substituted property includes property described in subparagraph 88(1)(*c.3*)(i) and (ii), but excludes property described in subparagraphs 88(1)(*c.3*)(iii) to (v). Substituted property is a concept used in subparagraph 88(1)(*c*)(vi), which describes certain property that is ineligible for the cost base increase (or bump) in paragraph 88(1)(*c*).

Subparagraph 88(1)(*c.3*)(i) provides that, for the purposes of clause 88(1)(*c*)(vi)(B), substituted property includes property (other than a specified property) owned by a person after the acquisition of control of the subsidiary where the fair market value of the property is wholly or partly attributable to property distributed to the parent on the winding-up. Subparagraph 88(1)(*c.3*)(i) is amended to limit its application to cases where more than 10% of the fair market value of the property owned by a person after the acquisition of control is attributable to the particular property or properties distributed to the parent on the winding-up.

This amendment is intended to permit the acquisition of property described in that subparagraph without denying the bump provided that not more than 10% of the fair market value of the acquired property is attributable to property distributed to the parent on the winding-up. The 10% threshold is meant to limit the type of property that is deemed to be substituted property and to simplify the application of the bump denial rule. In this respect, the addition of the 10% threshold reduces the need to create an exhaustive list of acceptable properties in the definition "specified property" in paragraph 88(1)(*c.4*).

This amendment applies to windings-up that begin, and amalgamations that occur, after December 20, 2012.

ITA
88(1)(*c.4*)(ii)

Paragraph 88(1)(*c.4*) of the Act defines "specified property" for the purposes of subparagraphs 88(1)(*c.3*)(i) and (v). Specified property is not substituted property within the meaning of subparagraph 88(1)(*c.3*)(i). Subparagraph 88(1)(*c.4*)(ii) provides that an indebtedness that was issued by the parent as consideration for the acquisition of a share of the capital stock of the subsidiary by the parent is a specified property.

Subparagraph (*c.4*)(ii) is amended to apply to indebtedness issued by the parent for consideration that consists solely of money. This amendment applies to windings-up that begin, and amalgamations that occur, after 2001.

ITA
88(1)(*c.4*)(v) and (vi)

Subparagraphs 88(1)(*c.4*)(v) and (vi) of the Act describe certain types of property that are considered to be specified property for the purposes of paragraph 88(1)(*c.4*) and subparagraphs (*c.3*)(i) to (v). Specified property is excluded from the extended meaning of substituted property found in paragraph 88(1)(*c.3*).

Paragraph 88(1)(*c.4*) is further amended in three respects. First, subparagraphs 88(1)(*c.4*)(v) and (vi) are combined into new subparagraph 88(1)(*c.4*)(v), which removes the requirement in former subparagraph 88(1)(*c.4*)(v) that any shares of the parent issued on an amalgamation in exchange for shares of the subsidiary be redeemed, acquired or cancelled by the parent immediately after the amalgamation for money. The issue that this amendment addresses is set out in the following excerpt from a Department of Finance comfort letter dated May 2, 2002:

> *Your concern relates to a series of proposed transactions wherein a taxable Canadian corporation ("Bidco") acquires more than 66 2/3% but less than 90% of the shares of another corporation ("Targetco") under a takeover bid. To complete the takeover, Bidco implements what is commonly referred to as an amalgamation squeeze out. On the amalgamation, a new corporation ("Amalco") will issue common shares to Bidco and redeemable preferred shares*

> *to the minority shareholders of Targetco. Amalco will redeem the redeemable preferred shares immediately after the amalgamation for consideration that includes common shares of Bidco, as required under the applicable securities law. Following the redemption, Amalco will be a wholly-owned subsidiary of Bidco. Amalco will then be wound up into Bidco.*
>
> *Your concern is that the redeemable preferred shares and the common shares of Bidco would not qualify as specified property as defined in paragraph 88(1)(c.4) of the Act and, therefore, such shares will be substituted property as defined in subparagraph 88(1)(c.3)(i) of the Act. Accordingly, the addition to the adjusted cost base of certain non-depreciable capital property of Amalco (the "bump") provided in paragraphs 88(1)(c) and (d) of the Act would be unavailable on the winding-up of Amalco into Bidco.*
>
> *In your view, the redemption of the redeemable preferred shares for common shares of Bidco does not violate any policy objectives underlying the bump rules. You state that, if the minority shareholders had tendered their shares of Targetco to Bidco under the takeover bid, the Bidco common shares received by them would have been specified property and, as a result, would not have been substituted property for the purpose of subparagraph 88(1)(c.3)(i). Accordingly, you request that we consider amending the definition of specified property in paragraph 88(1)(c.4) to accommodate the redemption of the redeemable preferred shares of Amalco for common shares of Bidco.*

This amendment applies to windings-up that begin, and amalgamations that occur, after 2001.

Second, amended subparagraph 88(1)(*c.4*)(vi) provides that a share of the capital stock of a corporation issued to a person described in clause 88(1)(*c*)(vi)(B) is specified property if all the shares of the capital stock of the subsidiary were acquired by the parent for consideration that consists solely of money. This amendment effectively applies to windings-up that begin, and amalgamations that occur, after 2001 and before December 21, 2012 (subject to transitional relief for certain windings-up that begin, and amalgamations that occur, before July 2013).

Third, subparagraph 88(1)(*c.4*)(vi) is repealed. This amendment applies in respect of windings-up that begin, and amalgamations that occur, after December 20, 2012 (subject to grandfathering for certain windings-up that begin, and amalgamations that occur, before July 2013). This repeal is consequential on the amendment of subparagraph 88(1)(*c.3*)(i) to limit its application to cases where more than 10% of the fair market value of the property owned by a person after the acquisition of control is attributable to the particular property or properties. Accordingly, after December 20, 2012, the 10% threshold applies and subparagraph 88(1)(*c.4*) is limited to the types of property previously described in that paragraph, with minor amendments to broaden the type of property that may be acquired in the course of an amalgamation squeeze-out.

ITA
88(1)(*c.9*)

New paragraph 88(1)(*c.9*) of the Act provides that, for the purposes of paragraph 88(1)(*c.4*), a reference to a share of the capital stock of a corporation includes a right to acquire a share of the capital stock of the corporation. This relieving change addresses a concern discussed in various Department of Finance comfort letters regarding the treatment of an option or a warrant as specified property where the option or warrant confers a right on the holder to acquire a share of the capital stock of a corporation that is specified property as defined by paragraph 88(1)(*c.4*).

This amendment applies to windings-up that begin, and amalgamations that occur, after 2001.

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

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 certain capital property (i.e., eligible 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.

Subparagraph 88(1)(*d*)(ii) is amended to limit the amount of the bump available in respect of property of the subsidiary acquired by the parent on the winding-up of the subsidiary. The amount designated in respect of any capital property eligible for a bump cannot exceed the amount determined by the formula A – (B + C) where

A is the amount that is the fair market value of the property at the time the parent last acquired control of the subsidiary, and

B is the amount that is the greater of the cost amount to the subsidiary of the property at the time the parent last acquired control of it and the cost amount to the subsidiary of the property immediately before the winding-up, and

C is the prescribed amount. For the prescribed amount, see subsections 5905(5.13) and (5.14) of the *Income Tax Regulations*. The prescribed amount is Nil except in the case of a foreign affiliate.

This change responds to transactions in which the amount of the bump available is increased by reducing the cost amount of the subsidiary's property (for example, a partnership interest or share of another corporation) after the acquisition of control of the subsidiary and before its winding-up. The Canada Revenue Agency challenges these transactions where appropriate, including under the general anti-avoidance rule. However, specific legislative action is warranted to explicitly preclude such manipulations as well as to ensure that the amount of any particular bump in the cost of eligible property is appropriate.

This amendment applies to windings-up that begin, and amalgamations that occur, after December 20, 2012 with grandfathering for certain windings-up that begin, and amalgamations that occur, before July 2013.

Business limit, qualifying income limit and balance-due day of parent

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

Paragraph 88(1)(*e.9*) of the Act applies for the purposes of the definition "qualifying corporation" in subsection 127.1(2) and for the one-month extension of the corporation's balance-due day under subparagraph (*d*)(i) of the definition "balance-due day" in subsection 248(1). The definition "qualifying corporation" is relevant for determining a new corporation's eligibility for refundable investment tax credits under section 127.1.

Clauses 88(1)(*e.9*)(i)(A) and (ii)(A) provide that a parent corporation's taxable income for a specified previous taxation year is increased by the taxable income of its subsidiary for the subsidiary's taxation years that end in the same calendar year as the specified previous taxation year. Clauses

88(1)(*e.9*)(i)(B) and (ii)(B) provide a similar rule for computing the parent corporation's business limit for the specified previous taxation year. The specified previous taxation year is consistent with the taxation year specified under the definition "qualifying corporation" in subsection 127.1(2) and under subparagraph (*d*)(i) of the definition "balance-due day" in subsection 248(1).

However, the qualifying income limit of a corporation is also relevant for the purposes of the definition "qualifying corporation" in subsection 127.1(2). Therefore, new clauses 88(1)(*e.9*)(i)(C) and (ii)(C) are introduced to provide that a parent corporation's qualifying income limit for a specified previous taxation year is increased by the qualifying income limits of its subsidiary for the subsidiary's taxation years that end in the same calendar year as the specified previous taxation year.

In addition, subparagraph 88(1)(*e.9*)(iii), which applies where parent and the subsidiary are associated with each other, is amended to add a reference to qualifying income limit.

Consistent with the application date of the definition "qualifying income limit" in subsection 127.1(2), these amendments apply to windings-up that begin after February 25, 2008.

Clause 41

Definitions

ITA
89(1)

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

"capital dividend account"

Where the appropriate elections have been made by a private corporation, dividends paid out of the capital dividend account of the corporation are received tax-free by the corporation's shareholders who are resident in Canada.

Paragraph (*d*) of the definition "capital dividend account" includes in computing the capital dividend account of a corporation the amount of certain net life insurance proceeds (proceeds minus the adjusted cost basis to the corporation of the policy) received by the corporation in consequence of the death of any person.

Paragraph (*d*) of the definition is amended so that a corporation's capital dividend account is not increased by any amount received in respect of an LIA policy. That paragraph is also amended to reduce the amount otherwise included under that paragraph in a corporation's capital dividend account by certain specified amounts, in respect of deaths that occur after 2013, under a 10/8 policy. Those amounts are, if the policy is a 10/8 policy immediately before the relevant death, the amount of any 10/8 borrowings, in respect of the policy, that remained outstanding immediately before the relevant death. For further information, see the commentary on the definitions "LIA policy" and "10/8 policy" in subsection 248(1).

Finally, paragraph (*d*) of the definition is also amended to update its structure to conform to modern drafting standards.

These amendments apply to taxation years that end after March 20, 2013.

Clause 42

Non-resident trusts

ITA
94

Section 94 of the Act sets out rules in respect of certain non-resident trusts in respect of which a Canadian resident, or former Canadian resident, is a contributor. In general, if a Canadian resident contributes property to a non-resident trust (other than an exempt foreign trust), the trust is deemed under paragraph 94(3)(*a*) to be resident in Canada for a number of purposes, and the contributor (except electing contributors), the trust and certain Canadian-resident beneficiaries of the trust may all become jointly and severally, or solidarily, liable to pay Canadian tax on the income of the trust.

Definitions

ITA
94(1)

Subsection 94(1) of the Act provides various definitions that apply for purposes of sections 94 and 94.2.

“arm’s length transfer”

A loan or transfer of property by a person or partnership in respect of a trust will generally not be considered a “contribution” to the trust where the loan or transfer is an “arm’s length transfer”.

The references to the term “majority interest partner” in the English version of the definition “arm’s length transfer” are replaced with references to “majority-interest partner”. These amendments are consequential on a similar amendment to the definition “majority-interest partner” in subsection 248(1). For further information, see the commentary on that definition.

This amendment comes into force on Royal Assent.

“specified party”

Certain persons are held jointly and severally, or solidarily, liable with each other and with a trust, that is deemed under section 94 to be a Canadian resident trust, for the trust’s unpaid Canadian tax liabilities. The maximum amount recoverable under these rules is determined by reference to the person’s recovery limit, if any, in respect of the trust. The person’s recovery limit is in turn computed by reference to certain amounts received by the person or by a specified party in respect of the person. The definition “specified party” applies for this purpose.

The references to the term “majority interest partner” in the English version of the definition “specified party” are replaced with references to “majority-interest partner”. These amendments are consequential on a similar amendment to the definition “majority-interest partner” in subsection 248(1). For further information, see the commentary on that definition.

This amendment comes into force on Royal Assent.

Excluded provisions

ITA
94(4)

Subsection 94(4) of the Act provides that the rules in paragraph 94(3)(*a*) that deem a non-resident trust to be resident in Canada do not apply for various enumerated purposes.

Paragraph 94(4)(*b*) is amended to add references to subsections 94(8.1) and (8.2) in the list of enumerated purposes. The references in those subsections to a "non-resident trust" are, therefore, to be read without reference to the deeming rule in paragraph 94(3)(*a*), with the result that those references include trusts that are otherwise deemed resident in Canada under paragraph 94(3)(*a*).

The enumerated purposes also include, as provided under paragraph 94(4)(*h*), determining whether subsection 75(2) applies to deem an amount to be an income, loss, taxable capital gain or allowable capital loss of the non-resident trust. Accordingly, the non-resident trust is considered not to be a Canadian-resident person in determining whether amounts are attributable to the trust from another trust under that subsection.

Paragraph 94(4)(*h*) is amended to provide that paragraph 94(3)(*a*) will also not apply for the purpose of determining whether subsection 75(2) applies. Subsection 75(2) continues not to apply to attribute amounts to another trust that would otherwise be deemed resident under subsection 94(3) and, as a result of this amendment, subsection 75(2) will also not apply to attribute amounts from a trust that is itself deemed resident under subsection 94(3). For further information, see the commentary on subsections 75(2) and 94(8.1) and (8.2).

This amendment applies to taxation years that end after March 20, 2013.

Effective ownership

ITA
94(8.1) and (8.2)

Section 94 of the Act is amended to add new subsections 94(8.1) and (8.2). The subsections ensure that the deemed residence rules for trusts in section 94 apply in respect of a non-resident trust that holds property on conditions that grant effective ownership of the property to a Canadian-resident person.

New subsection 94(8.1) provides for the conditions of application of new subsection 94(8.2). Subsection 94(8.2) will apply at any time to a particular person and to a particular property, in respect of a non-resident trust (determined without regard to the deemed Canadian residence rule in paragraph 94(3)(*a*)), if at that time

- the particular person in resident in Canada; and
- the trust holds the particular property on condition that the particular property or property substituted for the particular property
    - may revert to the particular person, or may pass to one or more persons or partnerships to be determined by the particular person, or
    - shall not be disposed of by the trust during the existence of the particular person, except with the particular person's consent or in accordance with the particular person's direction.

If the conditions of application in subsection 94(8.1) are satisfied at any time in respect of a particular person and a particular property held by a non-resident trust, then subsection 94(8.2) applies to, in effect, treat the particular person as having contributed to the trust the particular property (or, depending upon the circumstances, certain connected property, such as property for which the particular property is a substitute or property from which the particular property derives value). Specifically, subsection 94(8.2) provides that in applying the deemed residence rules in section 94 in respect of the trust for a taxation year of the trust that includes that time

- every transfer or loan made at or before that time by the particular person (or by a trust or partnership of which the particular person was a beneficiary or member) of the particular property, of another property for which the particular property is a substitute, or of property from which the particular property derives, or the other property derived, its value in whole or in part, directly or indirectly, is deemed to be a transfer or loan, as the case may be, by the particular person
    - that is not an arm’s length transfer, and
    - that is, for the purposes of paragraph 94(2)(*c*) and subsection 94(9), a transfer or loan of restricted property; and
- paragraph 94(2)(*c*) is to be read without reference to subparagraph 94(2)(*c*)(iii) in its application to each such transfer and loan.

By deeming the relevant transfers and loans of the particular person not to be arm’s length transfers (as otherwise defined in subsection 94(1)), the transfers and loans will be considered contributions (as defined in subsection 94(1)) to the trust by the particular person. In addition, by deeming the transfers and loans to be, for limited purposes, transfers and loans of restricted property, the extended transfer rule in paragraph 94(2)(*c*) will apply, and subsection 94(9) will apply to determine the amount of the contribution resulting from the transfers and loans failing to qualify as arm’s length transfers. Since the particular person will be resident in Canada, to the extent that the particular person is a contributor and resident contributor (as defined under subsection 94(1)) to the trust, the trust will be deemed to be resident in Canada under paragraph 94(3)(*a*), subject to the exemption for exempt foreign trusts.

These amendments apply to taxation years that end after March 20, 2013.

Clause 43

Members deemed carrying on business

ITA
96(1.6)

Subsection 96(1.6) of the Act deems residual members of a partnership that carries on a business in Canada to be carrying on business in Canada for the purposes of subsection 2(3). Subsection 96(1.6) is amended consequential on the enactment of subsection 34.2(18), which is part of the corporate partnership deferral rules introduced in 2011.

This amendment applies to taxation years that end after March 22, 2011.

Clause 44

Distributions from a trust

ITA
107(4.1)(*b*)

Subsection 107(2) of the Act allows certain trusts to distribute property to a capital beneficiary under the trust on a tax-deferred (i.e., rollover) basis. Subsection 107(4.1) prevents subsection 107(2) from applying to a distribution of trust property (the "distributed property") to a beneficiary under the trust where, generally, the trust attribution rule in subsection 75(2) was at any time applicable in respect of any property of the trust.

Paragraph 107(4.1)(*b*) provides that one of the conditions for the application of subsection 107(4.1) is that subsection 75(2) was applicable in respect of certain enumerated property. For this purpose, the determination of whether subsection 75(2) was applicable is made as though the subsection can apply to attribute amounts to a non-resident person and to a person in respect of which amounts are attributed under section 94 because the person is an electing contributor.

Paragraph 107(4.1)(*b*) is amended to provide that subsection 107(4.1) can also apply if new subsection 94(8.2) was applicable in respect of the same enumerated property. Subsection 94(8.2) applies in the circumstances described in subsection 94(8.1) involving a particular person having effective ownership of particular property held by a non-resident trust. For the purposes of paragraph 107(4.1)(*b*), the determination of whether subsection 94(8.2) was applicable is made as though a particular person described in subsection 94(8.1) can be a non-resident person. For further information, see the commentary on subsections 94(8.1) and (8.2).

Paragraph 107(4.1)(*c*) prevents the application of subsection 107(2) in respect of a distribution otherwise described in subsection 107(4.1), unless the beneficiary to whom the relevant distribution is made is a qualifying beneficiary. A qualifying beneficiary is the specified person to whom amounts are attributable under subsection 75(2) as described by paragraph 107(4.1)(*b*) (i.e., within the extended application of subsection 75(2) provided for by that paragraph) provided that the distributed property is property directly or indirectly received by the trust from the person, or property substituted for such a property. A qualifying beneficiary also includes the specified person's Canadian-resident spouse or common-law partner and a Canadian-resident trust to which the specified person is eligible to transfer property as described in section 73.

Although paragraph 107(4.1)(*c*) is not amended, the amendments described above to 107(4.1)(*b*) have the effect of extending existing paragraph 107(4.1)(*c*) to include as a qualifying beneficiary – if subsection 94(8.2) was applicable as described in paragraph 107(4.1)(*b*) (i.e., within the extended application of subsection 94(8.2) provided for by that paragraph) – the particular person (other than a trust described in subparagraph 107(4.1)(*b*)(ii)) referred to in subsection 94(8.2) in respect of the trust provided that the distributed property is property directly or indirectly received by the trust from the person, or property substituted for such a property. A qualifying beneficiary in this circumstance also includes the particular person's Canadian-resident spouse or common-law partner and a Canadian-resident trust to which the particular person is eligible to transfer property as described in section 73.

Paragraph 107(4.1)(*d*) prevents the application of subsection 107(2) in respect of a distribution otherwise described in subsection 107(4.1) if the specified person described in subparagraph 107(4.1)(*c*)(i) exists at the time of the distribution. Although paragraph 107(4.1)(*d*) is not amended, the amendments described above to 107(4.1)(*b*) also have the effect of extending existing paragraph

107(4.1)(*d*) to describe, if subsection 94(8.2) was applicable as described in paragraph 107(4.1)(*b*) (i.e., within the extended application of subsection 94(8.2) provided for by paragraph 107(4.1)(*b*)), the particular person described by subparagraph 107(4.1)(*c*)(i) in respect of the trust (i.e., the particular person referred to in subsection 94(8.2) in respect of the trust provided that the distributed property is property directly or indirectly received by the trust from the person, or property substituted for such property.)

For further information, see the commentary on subsections 94(8.1) and (8.2).

These amendments apply to taxation years that end after March 20, 2013.

Clause 45

Ceasing to be a qualifying environmental trust

ITA
107.3

Section 107.3 of the Act sets out a number of rules dealing with the taxation of the beneficiaries of a qualifying environmental trust (as defined in subsection 248(1)).

ITA
107.3(3)

Subsection 107.3(3) of the Act sets out a number of the tax consequences that apply if a trust ceases to be a qualifying environmental trust (QET) at any time: under paragraph 107.3(3)(*a*), the trust's taxation year is deemed to have ended (with the result that Part XII.4 of the Act will apply to the trust for that taxation year), and under paragraph 107.3(3)(*b*) the trust is deemed to have disposed of each of its properties at their fair market value immediately before that time and to have required each such property immediately after that time at a cost equal to those proceeds.

Consequential on an amendment to extend subsection 149(10) to trusts, paragraphs 107.3(3)(*a*) and (*b*) are replaced by new paragraph 107.3(3)(*a*), which deems a trust to cease to be exempt from tax under Part I of the Act at the time at which the trust ceases to be a QET. Under subsection 149(10), such trusts continue to be subject to a deemed year-end and a deemed disposition of property. Subsection 107.3(3) also continues to apply on a loss of QET status at any time whether the trust remains exempt from tax under subsection 149(1) at that time or not. For further information, see the commentary on subsection 149(10).

Paragraphs 107.3(3)(*c*) and (*d*) are, as a consequence of this amendment, renumbered as paragraphs 107.3(3)(*b*) and (*c*).

These amendments come into force on March 21, 2013.

Clause 46

Lifetime capital gains exemption

ITA
110.6(2), (31) and (32)

The formula in paragraph 110.6(2)(*a*) of the Act provides a lifetime limit for the total amount of capital gains deductions that an individual may claim in respect of qualified farm property (and by virtue of subsections 110.6(2.1) and (2.2) in respect of qualified small business corporation shares and qualified fishing property). Paragraph 110.6(2)(*a*) is amended to increase the limit from $375,000 to

$400,000, effective for the 2014 taxation year. This amount will be indexed to the Consumer Price Index (CPI) for the 2015 and subsequent taxation years. For further information, see the commentary on subsection 117.1(1).

Subsections 110.6(31) and (32) restrict the amount of lifetime capital gains exemption (LCGE) that can be claimed for a taxation year in respect of a capital gains reserve included in income in the year that is attributable to a property disposed of before March 19, 2007. These subsections are intended to prevent an individual from claiming a capital gains deduction for a taxation year beginning after March 19, 2007 (i.e., when the LCGE is $375,000) in respect of such a reserve, except to the extent that the individual could have claimed an additional deduction for the taxation year in which the disposition occurred without exceeding the LCGE of $250,000 (as it was for taxation years that began before March 20, 2007) if the individual had not claimed a reserve in that earlier year. An individual should not benefit from the increase to the LCGE (from $250,000 to $375,000) by claiming a capital gains reserve under paragraph 40(1)(*a*)(iii) in the year of the disposition of a property.

As a result of indexing, the LCGE will now increase along with increases in the CPI. Subsections 110.6(31) and (32) are replaced with new subsection 110.6(31) to provide that, for a disposition of property that is eligible for a capital gains deduction for the taxation year of disposition, a deduction for a future year is not available in respect of the disposition except to the extent of the LCGE for the taxation year of the disposition.

This amendment applies in respect of dispositions in taxation years beginning after March 19, 2007, the date on which the LCGE increased from $250,000 to $375,000.

In particular, new subsection 110.6(31) may apply for a taxation year for which an individual includes in income all or part of a prior year reserve. The capital gains deduction otherwise deductible is reduced by the difference between the amount the individual would be able to deduct for the year without reference to subsection 110.6(31) and the amount the individual would have been able to deduct in the year if he or she had not claimed any capital gains reserves in prior years and had for those years deducted all amounts that would have been deductible under section 110.6.

Example 1

In 2013, Ben has a taxable capital gain of $50,000 from a disposition of qualified farm property. At the time, Ben has already used $350,000 of the existing $375,000 LCGE limit. As a result of unpaid balance of proceeds of disposition, he claims a reserve of $25,000 under subparagraph 40(1)(a)(iii) for 2013 and includes the remaining $25,000 in income. Ben also claims a $25,000 capital gains deduction.

For 2014, Ben includes the $25,000 capital gains reserve carried forward from 2013 in income, and does not claim a new reserve. Because of the $400,000 LGCE limit for 2014, Ben would, absent subsection 110.6(31), be able to claim a $25,000 capital gains deduction to offset the income inclusion. However, the potential $25,000 capital gains deduction is reduced by the amount determined by the formula (A – B) in subsection 110.6(31) where:

> *A is the total of all amounts each of which is an amount deductible as a capital gains deduction for the year or a preceding taxation year, computed without reference to this rule. This amount is $400,000. Ben deducted a total of $375,000 for taxation years before 2014, and had another $25,000 available for the 2014 taxation year.*

B is the total of amounts that would have been deductible as capital gains deductions for the year or a preceding taxation year if the individual

- *had not, for any preceding taxation year, claimed a capital gains reserve, and*
- *had claimed, for each preceding taxation year, the capital gains deduction that would have been deductible.*

This amount is $375,000. If Ben had not claimed a $25,000 reserve for 2013, there would be no taxable capital gain to apply against the increased LCGE limit of $400,000.

Ben's available capital gains deduction is reduced by $400,000 - $ 375,000 = $25,000. Therefore, the capital gains deduction that Ben can claim for 2014 is nil (i.e., the capital gains deduction otherwise available of $25,000 less the amount determined under subsection 110.6(31) of $25,000).

Example 2

In 2014, Robert disposes of qualified farm property and has a taxable capital gain of $75,000. Robert has previously used $335,000 of the $400,000 LCGE limit. As a result of unpaid proceeds of disposition, he claims a reserve of $50,000 under subparagraph 40(1)(a)(iii) for 2014 and includes the remaining $25,000 in income. As a consequence, Robert claims a $25,000 capital gains deduction for the year. For 2015, Robert claims a reserve of $25,000 under subparagraph 40(a)(iii) and includes $25,000 in income. Also in 2015, Robert has a $20,000 taxable capital gain from another disposition of qualified farm property – no reserve is claimed in respect of that other disposition. For 2016, the prior year's reserve of $25,000 is included in income.

Assume that increases in the CPI increase the LCGE limit by $10,000 in each of 2015 and 2016 (i.e., to $410,000 and $420,000, respectively).

Robert's total taxable capital gains for 2015 from qualified farm property is $45,000 (i.e., $25,000 + $20,000). Absent the application of subsection 110.6(31), he could take a capital gains deduction in respect of the $45,000 because the LCGE limit for 2015 of $410,000 exceeds Robert's previously claimed capital gains deductions (i.e., $335,000 + $25,000 = $360,000) by more than $45,000.

The capital gains deduction available will be reduced by the amount determined by the formula (A - B) in subsection 110.6(31). In this case,

A = $405,000. This is the total of $360,000 in capital gains deductions claimed for prior years and the $45,000 capital gains deduction claimed for 2015.

B = $410,000. If Robert had not claimed a reserve for 2014, he could claim a capital gains deduction of $65,000 (i.e., up to the LCGE limit of $400,000). Then, for 2015 he could claim a $10,000 capital gains deduction in respect of the $20,000 taxable capital gain in that year (i.e., up to the LCGE limit of $410,000 for 2015).

A - B is a negative number (-$5,000) and section 257 applies to deem the amount determined by the formula to be nil. Therefore, there is no reduction to the $45,000 capital gains deduction that may be claimed by Robert for 2015.

For 2016, Robert includes the prior year's reserve of $25,000 in income. Robert's LCGE limit is increased to $420,000 for 2016. Of this amount, he has claimed $405,000 in capital gains deductions in prior years (i.e., $335,000 + $25,000 + $45,000 = $405,000).

But for the application of subsection 110.6(31), Robert would be able to claim for 2016 a capital gains deduction of $15,000 (i.e., $420,000 - $405,000). This is reduced by the amount determined by the formula (A - B) in subsection 110.6(31). For this year,

> *A = $420,000, the total of amounts deductible for current and prior years (if subsection 110.6(31) did not apply), which is the amount claimed up to 2015 plus the capital gains deduction available for 2016 of $15,000.*
>
> *B = $410,000. If Robert had not claimed a capital gains reserve for any year and had claimed the full capital gains deduction available in respect of each disposition, his 2014 taxable capital gain would have been $75,000 and his capital gains deduction would be $65,000 (i.e., up to the LCGE limit for 2014 of $400,000). For 2015, he would have no reserve to include in income and would have a $10,000 capital gains deduction (i.e., up to the LCGE limit for 2015 of $410,000) in respect of his taxable capital gain of $20,000 in the year. There would be no reserve included income for 2016, so there would been no capital gains deduction for the year.*
>
> *A - B = $10,000.*

As a result, the maximum capital gains deduction Robert could claim for 2016 is $5,000 (i.e., $15,000 less the $10,000 determined under subsection 110.6(31)). Subsection 110.6(31) prevents Robert from taking advantage of an increase in the LCGE limit for a year subsequent to the year in which the relevant disposition took place – in this instance, the increase in the LCGE limit from $410,000 for 2015 to $420,000 for 2016.

Clause 47

Loss restriction event – losses

ITA
111

Section 111 of the Act provides rules relating to the treatment of losses, and in particular establishes the extent to which a taxpayer is permitted to deduct, in computing taxable income for a taxation year, losses of other years.

ITA
111(4) to (5.3) and (5.5)

Subsections 111(4) to (5.3) and (5.5) of the Act apply to constrain a corporation's ability to deduct, in computing taxable income for a taxation year, losses of other years if there has been an intervening acquisition of control of the corporation. For example, under subsection 111(4), a corporation that undergoes an acquisition of control is required to recognize, for income tax purposes, all of its accrued capital losses on property that the corporation owns at that time. Those newly-realized capital losses, together with the corporation's existing net capital losses, cannot be used after the acquisition of control. The corporation can, however, elect to realize any accrued capital gains on other property that the corporation owns, allowing it to use some or all of its capital losses to offset those capital gains.

Subsections 111(4) to (5.3) and (5.5) are amended to extend their application to trusts. Specifically, those subsections, as amended, apply if a taxpayer that is a corporation or trust is subject to a loss restriction event. An existing rule that suspends some of the rules in those subsections if at the time of the loss restriction event the taxpayer ceases to be, or becomes, exempt from tax, is preserved, but moved to new paragraph 111(5.5)(*a*). For further information, see the commentary on section 251.2.

These amendments come into force on March 21, 2013.

ITA
111(8)

Subsection 111(8) of the Act defines a number of terms for purposes of section 111.

"farm loss"

Section 111 of the Act provides rules relating to the treatment of losses and establishes the extent to which amounts may be deducted in computing a taxpayer's taxable income for a taxation year in respect of losses incurred in other taxation years. The definition "farm loss" in subsection 111(8) is amended to remove a reference to the amount determined for C in the formula in the definition "non-capital loss" in subsection 111(8). Variable C in that formula was repealed by S.C. 2000, c. 19.

This amendment comes into force on Royal Assent.

"net capital loss"

The definition "net capital loss" computes the amount of a capital loss not used in the year in which the loss was recognized that can be carried over for use in another taxation year. Net capital losses may be carried forward indefinitely. Certain capital losses realized on the sale of shares or other securities of a small business corporation are treated separately as allowable business investment losses (ABILs). ABILs that cannot be deducted in the 20-year carry-forward period for non-capital losses may generally be carried forward, on the expiry of that period, indefinitely as net capital losses. However, if the taxpayer is a corporation the control of which is acquired during the carry-forward period for non-capital losses, the loss cannot be included in the corporation's net capital loss (i.e., paragraph (*c*) of variable C of the formula in the definition applies to reduce to nil the amount determined under the variable).

Paragraph (*c*) in the description of C of the definition "net capital loss" is amended to extend its application to trusts. Specifically, the rule now applies to a corporation or trust that is subject to a loss restriction event. For further information, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

ITA
111(12)

Subsection 111(12) of the Act extends the general treatment of accrued capital gains and losses on an acquisition of control of a corporation to a corporation's accrued capital gains and capital losses resulting from foreign currency fluctuations on debt liabilities denominated in a foreign currency. These rules apply only to foreign currency debts the repayment of which would have generated a capital loss or gain. Subsection 111(12) provides that for the purposes of subsection 111(4), if at any time a corporation owes a foreign currency debt, the corporation is deemed to own, immediately before that time, a property with an adjusted cost base and fair market value determined by the formulas contained in paragraphs 111(12)(*a*) and (*b*), respectively.

Subsection 111(12) is amended to extend its application to trusts, consequential on the extension of subsection 111(4) to trusts. For further information, see the commentary on sections 111 and 251.2.

This amendment comes into force on March 21, 2013.

Clause 48

Synthetic disposition – holding period

ITA
112(8) and (9)

Subsections 112(3) to 112(7) provide "stop-loss" rules that reduce, in certain cases, the amount of a loss otherwise realized by a corporation on a disposition of shares by the amount of tax-free dividends received by the corporation on the shares. These stop-loss rules are subject to exceptions that apply depending on whether the corporate shareholder holds the share as a capital property, an income property or a mark-to-market property. For certain of these exceptions to apply, the shares must be held throughout the 365-day period that ends immediately before their disposition. These exceptions are contained in paragraphs 112(3.01)(*b*) and (3.11)(*b*), subclauses (3.2)(*a*)(ii)(C)(I) and (3.3)(*a*)(ii)(C)(I) and paragraphs (3.31)(*b*), (3.32)(*b*), (4.01)(*b*), (4.11)(*b*), (4.21)(*b*), (4.22)(*b*), (5.1)(*b*) and (5.21)(*b*).

New subsection 112(8) is added to ensure that taxpayers cannot circumvent the application of the stop-loss rules by entering into a synthetic disposition arrangement in order to meet the 365-day ownership requirement. Subsection 112(8) provides that, if a synthetic disposition arrangement is entered into in respect of a property owned by a taxpayer and the synthetic disposition period in respect of the synthetic disposition arrangement is 30 days or more, then for the purposes of the listed exceptions to the stop-loss rules, the taxpayer is deemed not to own the property during the synthetic disposition period. As a consequence, unless the taxpayer continues to own the property for more than one year after the end of the synthetic disposition period, the 365-day test in the exceptions will generally not be met. The new terms "synthetic disposition arrangement" and "synthetic disposition period" are defined in subsection 248(1).

New subsection 112(9) provides that subsection 112(8) does not apply to a taxpayer in respect of a property owned by a taxpayer in respect of a synthetic disposition arrangement if the taxpayer owned the property throughout the 365-day period that ended immediately before the synthetic disposition period in respect of the synthetic disposition arrangement. In determining whether a taxpayer owned the property throughout the 365-day period, the taxpayer will not be considered to own the property throughout that period if subsection 112(8) previously applied in respect of the property during that period or would have previously applied if the determination in subsection 112(8) were made without reference to subsection 112(9). This ensures that subsection 112(8) applies only where a synthetic disposition arrangement is used to allow a taxpayer to meet a 365-day hold period test that the taxpayer otherwise would not have met.

Subsections 112(8) and (9) generally apply to agreements and arrangements entered into after March 20, 2013. They also apply to an agreement or arrangement entered into before March 21, 2013, the term of which is extended after March 20, 2013, and they apply to the agreement or arrangement as if the agreement or arrangement were entered into at the time of the extension.

Clause 49

Annual adjustment

ITA
117.1(1)

Subsection 117.1(1) of the Act provides for the indexing of various amounts in the Act, based on annual increases to the Consumer Price Index. Subsection 117.1(1) is amended to extend its application to the reference to the amount of $400,000 in the formula in paragraph 110.6(2)(*a*) (the lifetime capital gains exemption limit).

This amendment applies to the 2015 and subsequent taxation years.

Clause 50

Inclusion of ancillary fees and charges

ITA
118.5(3)

Subsection 118.5(3) of the Act allows an individual to include, for the purpose of calculating the tuition tax credit under subsection 118.5(1), certain mandatory ancillary fees and charges paid to a post-secondary educational institution in respect of the individual's enrolment at the institution. Certain fees or charges are not eligible for this treatment. For instance, fees related to the provision of financial assistance to the individual are excluded by subparagraph 118.5(3)(*c*)(iv), except to the extent that the financial assistance would be taxable as a scholarship or other amount described in paragraph 56(1)(*n*).

Subparagraph 118.5(3)(*c*)(iv) is amended to clarify that fees related to the provision of financial assistance are excluded except to the extent that the amount of the assistance is required to be included in computing the income of the individual or would be required to be included but for the scholarship exemption in subsection 56(3).

This amendment applies to the 2012 and subsequent taxation years.

Clause 51

SIFT trusts

ITA
122.1

Section 122.1 of the Act sets out rules that apply in respect of the taxation of specified investment flow-through (SIFT) trusts and, in some cases, SIFT partnerships. "SIFT trust" is defined in subsection 122.1(1), and "SIFT partnership" is defined in section 197. Subsection 248(1) makes both definitions apply for all purposes of the Act.

Section 122.1 is amended by modifying two existing definitions.

"non-portfolio property"

Non-portfolio property defines certain types of property held by a trust or partnership. The definition "non-portfolio property" is amended to clarify that non-portfolio property of a corporation has the same meaning as it does in respect of property of a trust or partnership. This change also provides greater certainty as to which corporations qualify as portfolio investment entities.

This amendment applies to taxation years that end after July 20, 2011.

"excluded subsidiary entity"

The definition "excluded subsidiary entity" is relevant to determining whether a trust or partnership is a SIFT trust or SIFT partnership for a taxation year. A trust or partnership that is an excluded subsidiary entity is not a SIFT trust or SIFT partnership.

To qualify as an excluded subsidiary entity for a taxation year, an entity must meet two conditions at all times during the taxation year. The first is that the entity's equity (including equity-like debt) is not listed or traded on a stock exchange or other public market at any time in the taxation year. The second is that its equity is not held at any time in the taxation year by any person or partnership other than certain qualifying interest holders. Currently, only REITs, taxable Canadian corporations, SIFTs and other excluded subsidiary entities are qualifying interest holders.

Paragraph (*b*) of the definition "excluded subsidiary entity" is amended, by modifying subparagraph (v), to expand the list of qualifying interest holders to include persons or partnerships that do not have, in connection with the holding of a security of the entity, property the value of which is determined, all or in part, by reference to a security that is listed or traded on a stock exchange or other public market. Existing subparagraph (v) is moved to new subparagraph (vi).

Example

A partnership (the "LP") is formed under the laws of a province between a taxable Canadian corporation whose common shares are listed on a stock exchange (the "Corporation") and an entity that is exempt from tax under section 149 of the Act (the "Tax-Exempt"). There are no other partners in the LP (i.e., none of the LP's equity is publicly-traded). The LP carries on an active business in Canada, and therefore holds non-portfolio property and generates non-portfolio earnings. Assume that investments in the LP, by virtue of the Corporation's shares trading publicly, are determined to be listed or traded on a stock exchange or other public market within the meaning of paragraph (b) of the definition "SIFT partnership" in subsection 197(1) of the Act.

Results

Since the LP was formed with the Corporation as one partner and the Tax-Exempt as the other partner, the existing definition "excluded subsidiary entity" would not apply because the Tax-Exempt is not listed as a qualifying interest holder in paragraph (b) of that definition.

With the addition of new subparagraph (b)(v) to the list of qualifying interest holders under the definition "excluded subsidiary entity", the Tax-Exempt will qualify as an entity that is permitted to hold equity in the LP without triggering SIFT status for the LP – as long as the Tax-Exempt does not have, in connection with the holding of its interests in the LP, any right to property the value of which is determined in any part by reference to a publicly-traded security. Since the Corporation is already a qualifying interest holder under subparagraph (b)(ii) of the definition "excluded subsidiary entity", the LP will be able to rely on the definition to avoid being characterized as a SIFT partnership.

However, a tax-exempt entity will not be a qualifying interest holder under the amended definition in all cases. Each of the following examples (among others) would result in the Tax-Exempt having a right, in connection with the holding of its interests in the LP, to property the value of which is determined by reference to a publicly-traded security:

- *if the Tax-Exempt's interests in the LP were convertible into, or exchangeable for, common shares of the Corporation;*

- *if the Tax-Exempt's interests in the LP were convertible into, or exchangeable for, any other publicly-traded security;*
- *if the Tax-Exempt had a right (whether separate from, or forming part of, its interests in the LP) to redeem at a given time its interests in the LP in exchange for cash in an amount determined by reference to the value of common shares of the Corporation; or*
- *if the Tax-Exempt or one of its subsidiaries, in the course of the Tax-Exempt subscribing for its interests in the LP, enters into an arrangement with any party whereby the Tax-Exempt (or its subsidiary) has a right to transfer at a given time its interests in the LP for cash, or another property, the amount or value of which is determined by reference to the value of publicly-traded securities of any entity.*

In any of the cases listed above, the Tax-Exempt would be precluded from relying upon new subparagraph (b)(v) of the definition "excluded subsidiary entity", thereby implicating SIFT status for the LP.

This amendment is deemed to have come into force on October 31, 2006. However, in determining if an entity is an excluded subsidiary entity for taxation years of the entity that begin before July 21, 2011, the amendment will not apply if the entity so elects in writing filed with the Minister of National Revenue within 365 days after the day on which the enacting legislation receives royal assent.

Clause 52

Canada child tax benefit – non-residents and part-year residents

ITA
122.61(3)

Section 122.61 provides for the calculation of the Canada child tax benefit (CCTB), which provides federal assistance to families through three components: base benefits for low- and middle-income families; the national child benefit supplement, which provides additional assistance for low-income families; and the child disability benefit, which provides assistance to the family of each eligible child who meets the eligibility criteria for the disability tax credit.

Paragraph 122.61(3)(*b*) provides that, for the purposes of section 122.61, a non-resident person's "earned income" for the year includes only earned income that is taxable in Canada. Subsection 122.61(3) is restructured to repeal paragraph 122.61(3)(*b*), which is no longer required because of the repeal of the definition "earned income" in subsection 122.61(1) by S.C. 1998, c. 21.

This amendment comes into force on Royal Assent.

Clause 53

Canada child tax benefit – communication of information

ITA
122.64

Section 122.64 of the Act provides rules for the sharing of information obtained for the purposes of the *Family Allowances Act* or the Canada child tax benefit (CCTB). In general, this information may be shared for the purposes of the administration and enforcement of certain provincial and federal statutes. This section is repealed consequential on

- the repeal of the *Family Allowances Act*;

- the earlier enactment of subparagraphs 241(4)(*e*)(iii) and (viii) (regarding the *Canada Pension Plan* and the *Old Age Security Act*);
- the amendment of subparagraph 241(4)(*j.1*) (regarding information relevant to the calculation of the CCTB); and
- the amendment of paragraph 239(2.21)(*b*) and the addition of new paragraph 241(4)(*j.2*) (regarding the sharing and use of information for the purposes of administration and enforcement of a provincial law prescribed under new section 6500 of the *Income Tax Regulations*).

To ensure that taxpayer information is safe-guarded, section 241 prohibits the use or communication of taxpayer information by any official or other representative of the government except as otherwise authorized. New paragraph 241(4)(*j.2*), which replaces paragraph 122.64(2)(*a*), allows information relevant to the calculation of the CCTB to be provided to an official of the government of a province, solely for the purposes of the administration or enforcement of a prescribed law of the province.

Paragraph 122.64(2)(*b*) allows information obtained under the CCTB provisions or the *Family Allowances Act* to be provided to an official of the Department of Human Resources and Skills Development for the purposes of the administration of the *Family Allowances Act*, the *Canada Pension Plan* or the *Old Age Security Act*. This paragraph is repealed consequential on the repeal of the *Family Allowances Act* and the earlier enactment of subparagraphs 241(4)(*e*)(iii) and (viii), which allow information to be provided for the purposes of section 92 of the *Canada Pension Plan* and paragraph 33.1(*a*) of the *Old Age Security Act*, respectively.

Subsection 122.64(3) allows a taxpayer’s name and address, obtained under the child tax benefit provisions, to be communicated for the purposes of Part I of the *Family Orders and Agreements Enforcement Assistance Act*. This subsection is unnecessary because subparagraph 241(4)(*e*)(vii) provides for the release of information obtained under the child tax benefits provisions for the purposes of section 79 of the *Family Orders and Agreements Enforcement Assistance Act*.

Subsection 122.64(4) provides that the unauthorized use or communication of information obtained under subsection 122.64(2) or (3) constitutes an offence and any person convicted of such an offence is liable to a fine not exceeding $5,000, imprisonment or both. This subsection is repealed consequential on the amendment of paragraph 239(2.21)(*b*) to provide that unauthorized use or communication of information obtained under subparagraph 241(4)(*j.2*) will constitute an offence and any person convicted of such an offence is liable to a fine not exceeding $5,000, imprisonment or both.

The repeal of section 122.64 comes into force on Royal Assent.

Clause 54

Definitions

ITA
123.4(1)

“full rate taxable income”

Section 123.4 of the Act contains rules that allow a corporation to reduce its tax otherwise payable under Part I of the Act by a percentage of its full rate taxable income. The full rate taxable income of a corporation for a taxation year is, in general terms, that part of the corporation’s taxable income for the

year that is not exempt from tax and has not benefited from any of the various special effective tax rates provided under the Act. This amount is determined differently depending on the status of the corporation.

Subparagraph (*a*)(iv) of the definition "full rate taxable income" excludes from the full rate taxable income of a corporation that was a credit union throughout a taxation year the corporation's taxable income that was subject in the year to the additional deduction from tax otherwise payable available to credit unions under subsection 137(3).

Subparagraph (*a*)(iv) is amended to replace the reference to the amount determined for variable B in the formula in subsection 137(3) with a reference to the amount obtained when the amount determined for variable B in that formula is multiplied by the amount determined for variable C in that formula. This amendment is consequential on the phase-out for the additional deduction available to credit unions in subsection 137(3) contained in the *Economic Action Plan 2013 Act, No. 1*, S.C. 2013, c. 33 and is made to ensure that the taxable income of a credit union that does not benefit from the additional deduction is not precluded, because of subparagraph (*a*)(iv), from benefitting from the general rate reduction in subsection 123.4(2).

This amendment applies to taxation years that end after March 20, 2013.

Clause 55

Specified partnership income

ITA
125(7)

Subsection 125(7) of the Act provides definitions for certain terms used in section 125 in respect of the corporate "small business deduction" for Canadian-controlled private corporations (CCPCs). The term "specified partnership income" is defined in subsection 125(7) by reference to a formula and is used in determining the small business deduction of a CCPC that carries on an active business through a partnership.

The definition "specified partnership income" is amended in two ways consequential on the introduction of the corporate partnership deferral rules in section 34.2. First, the description of G – which refers to a corporation's share of income of an active business carried on in Canada by a corporation as a member of a partnership – in paragraph (*a*) of the description of A in the formula in the definition is amended to expressly refer to amounts included in the corporation's income for the year under subsections 34.2(2), (3) and (12) in respect of the business because of the corporate partnership deferral rules.

Second, a similar amendment is made to the description of H – which refers to a corporation's deductions in computing the corporation's income for the year from the business (other than amounts deducted by the partnership) – in paragraph (*a*) of the description of A in the formula in the definition to expressly refer to amounts deducted for the year by the corporation under subsections 34.2(4) and (11) in respect of the business because of the corporate partnership deferral rules.

These amendments apply to taxation years that end after March 22, 2011.

Clause 56

Synthetic disposition – holding period

ITA
126(4.5) and (4.6)

Section 126 of the Act provides rules under which a taxpayer may deduct, from tax otherwise payable, amounts that have been paid in respect of foreign tax.

Subsection 126(4.2) limits the foreign tax credit in respect of dividends or interest on a share or debt obligation held by the taxpayer for one year or less. Where it applies, subsection 126(4.2) limits the foreign tax credit to the amount of Canadian tax that would be payable at a notional rate on the gross income from a foreign country in which the tax was paid. Subsection 126(4.2) applies to arrangements where a person, who is subject to a foreign withholding tax on a particular source of income but is unable to obtain a foreign tax credit, effectively transfers that income to another person who is able to use the tax credit against Canadian tax on income from other sources in that foreign country.

New subsection 126(4.5) is introduced to ensure that a taxpayer cannot circumvent the application of subsection 126(4.2) by entering into a synthetic disposition arrangement that allows the taxpayer to legally own a property for a period of more than one year while not having any substantial risk of loss or opportunity for gain or profit in respect of the property during the period.

Subsection 126(4.5) provides that, if a synthetic disposition arrangement is entered into in respect of a property owned by a taxpayer and the synthetic disposition period in respect of the synthetic disposition arrangement is at least 30 days, for the purpose of determining whether the period referred to in subsection 126(4.2) is at least one year, the period is deemed to begin at the earlier of

- the time that is immediately before the particular time (i.e., the time at which the taxpayer disposes of the property) referred to in subsection 126(4.2), and
- the end, if any, of the synthetic disposition period.

As a consequence, unless the taxpayer continues to own the property for at least one year after the end of the synthetic disposition period, the one-year test in 126(4.2) will not generally be met.

The new terms “synthetic disposition arrangement” and “synthetic disposition period” are defined in subsection 248(1).

New subsection 126(4.6) generally provides that subsection 126(4.5) does not apply to a taxpayer in respect of a property owned by a taxpayer in respect of a synthetic disposition arrangement if the taxpayer owned the property throughout the one-year period that ended immediately before the synthetic disposition period of the synthetic disposition arrangement. In determining whether a taxpayer owned the property throughout the one-year period, the taxpayer will not be considered to own the property throughout that period if subsection 126(4.5) applied in respect of the property during that period or would have applied if the determination in subsection 126(4.5) were made without reference to subsection 126(4.6). This ensures that subsection 126(4.5) applies only where a synthetic disposition arrangement is used to allow a taxpayer to meet a one-year hold period test that the taxpayer otherwise would not have met.

New subsections 126(4.5) and (4.6) generally apply to agreements and arrangements entered into after March 20, 2013. They also apply to an agreement or arrangement entered into before March 21, 2013,

the term of which is extended after March 20, 2013, and they apply to the agreement or arrangement as if the agreement or arrangement were entered into at the time of the extension.

Clause 57

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.

Loss restriction event

ITA
127(9), (9.1) and (9.2)

"investment tax credit"

Subsection 127(5) of the Act provides for the deduction of investment tax credit (ITCs) from a taxpayer's Part I tax otherwise payable. The term "investment tax credit" is defined in subsection 127(9). The definition provides for the calculation of a taxpayer's ITCs at the end of a taxation year and allows ITCs for a year to be carried over, with certain limits, to other years. The definition 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 (*j*) and (*k*) of the definition restrict the carryover of unused ITCs by a corporation after control of the corporation is acquired. Specifically, paragraphs (*j*) and (*k*) reduce a corporation's ITC by the amounts determined under subsections 127(9.1) and 127(9.2).

Subsection 127(9.1) sets out the rules for determining the amount by which a corporation's carry-forward of unused ITCs earned before an acquisition of control is limited, under paragraph (*j*) of the definition of "investment tax credit", for claims against taxes payable in respect of income earned after the acquisition of control. Subsection 127(9.2) sets out the rules for determining the amount by which a corporation's carry-back of unused ITCs earned after an acquisition of control is limited, under paragraph (*k*) of the definition of "investment tax credit", for claims made against taxes payable in respect of income earned before the acquisition of control. The general effect of these rules is that a corporation cannot carry over amounts in respect of ITCs except to the extent of income tax arising in respect of income earned in the same or a similar business to that carried on before the acquisition of control.

Paragraphs (*j*) and (*k*) of the definition "investment tax credit" in subsection 127(9), and subsections 127(9.1) and (9.2), are amended to extend their application to trusts, by referring to a taxpayer that is subject to a loss restriction event. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

Definitions

ITA
127(9)

Subsection 127(9) of the Act provides various definitions relevant for the purpose of calculating a taxpayer's investment tax credits.

"non-government assistance"

The definition "non-government assistance" in subsection 127(9) is relevant for various provisions in section 127 that require the investment tax credit to be calculated by reference to the cost of property or the amount of an expenditure made net of any grant, inducement or other assistance received in respect of the cost of the property or the expenditure.

The definition is amended by replacing the reference to "subparagraphs 12(1)(*x*)(vi) and (vii)" with "subparagraphs 12(1)(*x*)(v) to (vii)". This amendment ensures that the definition "non-government assistance" in subsection 127(9) is consistent with the definition "assistance" in subsection 125.4(1).

This amendment comes into force on December 21, 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 an investment tax credit (ITC). 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 include certain expenses generally described in paragraphs (*f*) and (*g*) of the definition "Canadian exploration expense" (CEE) in subsection 66.1(6).

Subparagraph (*a*)(ii) of the definition "pre-production mining expenditure" is amended to add references to new paragraphs (*g.3*) and (*g.4*) of the definition of CEE, consequential on the phase-in of the transition from CEE to Canadian development expense for eligible pre-production mine development expenses incurred after March 20, 2013. This amendment ensures that CEE described in paragraphs (*g.3*) and (*g.4*) of the definition CEE will continue to earn ITCs during the phase-out of ITCs for the pre-production mining expenditures.

This amendment comes into force on March 21, 2013.

"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.

Clause (*k*)(iii)(B) of the definition "specified percentage" is amended to ensure that expenditures incurred in 2015 that are described in subparagraph (*a*)(ii) of the definition "pre-production mining expenditure" because of new paragraph (*g.4*) of the definition of "Canadian exploration expense" (CEE) in subsection 66.1(6) continue to earn ITCs at the proper rate. New paragraph (*g.4*) of the definition of CEE reduces the percentage of the eligible CEE to 80% of what would otherwise qualify as CEE for the purposes of pre-production mining expenditures. This amendment is consequential on the amendments to the definition of CEE to phase in the transition from CEE to Canadian development expense, as defined in subsection 66.2(5).

This amendment comes into force on March 21, 2013.

Clause 58

Refundable investment tax credit

ITA
127.1

Section 127.1 of the Act provides for the refundability of investment tax credits in certain circumstances.

Definitions

ITA
127.1(2)

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

“qualifying corporation”

A qualifying corporation may be eligible for either a 40% or 100% refund for its investment tax credits, depending on the nature of its expenditures. A qualifying corporation for a particular taxation year is a Canadian-controlled private corporation the taxable income of which for its preceding taxation year, together with the taxable incomes of all associated corporations for their preceding taxation years, does not exceed the qualifying income limit of the corporation for the particular year.

The definition is amended by adding the term “if any” after “does not exceed its qualifying income limit”. This amendment clarifies that a corporation can only be a qualifying corporation if it has a qualifying income limit.

This amendment applies to taxation years that begin after December 21, 2012.

Clause 59

Deduction of labour-sponsored funds tax credit

ITA
127.4(2)

Subsection 127.4(2) of the Act provides authority for the deduction of a labour sponsored-sponsored funds tax credit by an individual (other than a trust).

Subsection 127.4(2) is repealed concurrent with the phase-out of the labour sponsored-sponsored funds tax credit, effective for the 2017 and subsequent taxation years.

Labour-sponsored funds tax credit limit

ITA
127.4(5)

Subsection 127.4(5) of the Act sets out the calculation of an individual’s labour-sponsored funds tax credit limit for a taxation year. The limit is the lesser of $750 and the total of the individual’s labour-sponsored funds tax credits in respect of original acquisitions (as defined in subsection 127.4(1)) in the year or in the first 60 days of the following year of approved shares, except that original acquisitions reflected in the individual’s claim under subsection 127.4(2) for the preceding taxation year are ignored.

Subsection 127.4(5) is amended to phase out the labour-sponsored funds tax credit limit according to the same schedule as for the phase-out of the labour-sponsored funds tax credit. Specifically, the labour-sponsored funds tax credit limit will be reduced to $500 for the 2015 taxation year and to $250 for the 2016 taxation year. Subsection 127.4(5) is repealed effective for the 2017 and subsequent taxation years. Original acquisitions in the first 60 days of 2017 will continue to be eligible for the labour-sponsored funds tax credit for 2016.

Labour-sponsored funds tax credit

ITA
127.4(6)

Subsection 127.4(6) of the Act sets out the calculation of an individual's labour-sponsored funds tax credit in respect of an original acquisition (as defined in subsection 127.4(1)) of an approved share for a taxation year. This tax credit is generally equal to 15% of the net cost to the individual (or to a registered retirement savings plan or tax-free savings account of the individual) in respect of the original acquisition of the share by the individual or trust.

Subsection 127.4(6) is amended to phase out the labour-sponsored funds tax credit. Specifically, the credit will be reduced to 10% for the 2015 taxation year and to 5% for the 2016 taxation year. Subsection 127.4(6) is repealed effective for the 2017 and subsequent taxation years.

The labour-sponsored funds tax credit that applies to a given labour-sponsored funds tax credit deduction claim will be based on the taxation year that the labour sponsored funds tax credit is claimed, rather than the year in which an approved share is acquired. For instance, an original acquisition of an approved share that takes place in the first 60 days of 2015, but is claimed in respect of the 2014 taxation year, will be eligible for the 15% labour-sponsored funds tax credit.

Clause 60

Adjusted taxable income determined

ITA
127.52(1)(*c.1*)

Subsection 127.52(1) of the Act defines the "adjusted taxable income" of an individual for the purpose of determining the individual's minimum tax liability under Division E.1 of Part I of the Act. An individual's "adjusted taxable income" for a taxation year is the amount that would be the individual's taxable income for that year if the assumptions set out in paragraphs 127.52(1)(*b*) to (*j*) were made. In particular, paragraph 127.52(1)(*c.1*) applies to exclude certain losses deducted by a limited partner, a member of a partnership who has been a specified member since becoming a partner, or a partner whose interest is required to be, or has been, registered as a tax shelter under section 237.1.

The deduction of limited partnership losses is generally denied for Alternative Minimum Tax (AMT) purposes to the extent the taxpayer does not also realize taxable capital gains from the limited partnership in the same taxation year. Furthermore, the carryforward of those denied limited partnership losses to offset income for AMT purposes in a future year is not permitted. For further information, please see the commentary on paragraph 127.52(1)(*i*).

Paragraph 127.52(1)(*c.1*) is amended to apply to restrict an individual's limited partnership loss for the purpose of calculating the AMT only if the individual's interest in the partnership is an interest for which an identification number is required to be, or has been, obtained under section 237.1.

This amendment applies to the 2012 and subsequent taxation years and, if an individual files an election in writing with the Minister of National Revenue before the day that is 90 days after Royal Assent, to the individual's 2006 to 2011 taxation years as well.

ITA
127.52(1)(*i*)(i)(B)(II) and (ii)(B)(II)

For the purpose of calculating an individual's adjusted taxable income for the AMT, paragraph 127.52(1)(*i*) of the Act restricts the application of an individual's losses arising in other taxation years that are deductible in computing the individual's taxable income under Part I of the Act. Paragraph 127.52(1)(*i*) restricts the amounts of losses under section 111 for other taxation years that may be claimed for the purposes of calculating adjusted taxable income for AMT purposes. In general, if, for AMT purposes, such losses would have been reduced in calculating adjusted taxable income for the taxation years in which the losses arose, they will not be available in the calculating adjusted taxable income for the current taxation year. In this regard, clauses 127.52(1)(*i*)(i)(B) and (ii)(B) clarify that the calculation of those losses for the other years is by reference to how the relevant portions of subsection 127.52(1) applied in those other taxation years.

Clause 127.52(1)(*i*)(i)(B) is amended consequential on the amendment of paragraph 127.52(1)(*c.1*). Subclause 127.52(1)(*i*)(i)(B)(II) is amended to provide that, in computing the amounts deductible under paragraphs 111(1)(*a*), (*c*), (*d*) and (*e*) for AMT purposes for a taxation year, the amount of a taxpayer's non-capital loss, restricted farm loss, farm loss or limited partnership loss incurred in a taxation year that began after 1994 and ended before 2012 should be computed as if paragraphs 127.52(1)(*b*) to (*c.3*), (*e*) and (*e.1*) applied to restrict these amounts. In this regard, paragraphs 127.52(1)(*b*) to (*c.3*), (*e*) and (*e.1*) are to be read as they applied in respect of taxation years that began after 1994 and ended before 2012.

Similarly, subclause 127.52(1)(*i*)(i)(B)(III) is added with the same effect in respect of losses that arise in a taxation year that ends after 2011, except that paragraphs 127.52(1)(*b*) to (*c.3*), (*e*) and (*e.1*) are to be read as they applied in respect of taxation years that end after 2011.

Subclause 127.52(1)(*i*)(ii)(B)(II) is amended, and (ii)(B)(III) is added, in a similar manner, applicable in respect of the calculation of net capital losses.

These amendments generally apply to the 2012 and subsequent taxation years. However, if the election referred to in the commentary on paragraph 127.52(1)(*c.1*) is filed by an individual, the references in clauses 127.52(1)(*i*)(i)(B) and (ii)(B) to "2011" and "2012" are to be read as "2005" and "2006", respectively (i.e., these amendments will apply to the individual's 2006 to 2011 taxation years as well).

Clause 61

Cooperative corporations

ITA
136(1)

Section 136 of the Act provides rules that apply to cooperative corporations. For the purposes of the Act, cooperatives corporations are generally considered not to be private corporations. However, subsection 136(1) provides that a cooperative corporation that would otherwise be a private corporation is treated as a private corporation for the purposes of specified provisions, notably section 125. Subsection 136(1) is amended to add other provisions for which a cooperative can be treated as a

private corporation, and to put the provisions referred to in the subsection in numerical order. In particular, a cooperative corporation will be treated as a private corporation for the purposes of the rules relating to eligible dividends in respect of which Canadian-resident individual shareholders may obtain an enhanced dividend tax credit.

In general, section 89 sets out the rules for determining whether a corporation may make an eligible dividend designation. A Canadian-controlled private corporation (CCPC) may make an eligible dividend designation in respect of a taxable dividend that it pays to its Canadian-resident shareholders if it has a positive balance in its general rate income pool in respect of the dividend. Any other corporation may make an eligible dividend designation in respect of a taxable dividend to the extent that it does not have a low rate income pool. Because of the amendment to subsection 136(1), a cooperative corporation will be considered a private corporation, and possibly as a CCPC, when paying a taxable dividend to its shareholders. Subsection 136(1) is also amended to refer to other rules of the Act that are related to the eligible dividend rules, namely rules that apply in the context of amalgamations and windings-up of corporations, excessive eligible dividend designations and corporations becoming or ceasing to be a CCPC during a taxation year.

This amendment applies to taxation years that begin after December 21, 2012.

Clause 62

Credit unions

ITA
137(4.1)

Subsection 137(4.1) of the Act provides rules relating to the treatment of amounts paid or payable by a credit union in respect of an unlisted share of its capital stock. In particular, it provides that where such an amount is paid or payable to a member of the credit union, the amount (or, in certain circumstances, the portion of the amount in excess of the paid-up capital of the share) is treated as interest, rather than as a dividend.

Subsection 137(4.1) is amended in three respects. First, the subsection's structure is updated. Accordingly, the conditions for deemed interest treatment for amounts paid or payable by a credit union are set out in three new paragraphs. New paragraph 137(4.1)(*a*) provides the existing condition that the amount be in respect of a share held by a person of the capital stock of the credit union (other than an amount paid or payable as or on account of a reduction of the paid-up capital, redemption, acquisition or cancellation of the share by the credit union to the extent of the paid-up capital of the share). New paragraph 137(4.1)(*b*) provides the existing condition with respect to being listed on a stock exchange. New subparagraph 137(4.1)(*c*)(i) provides the existing condition that the amount be paid or payable to a member of the credit union.

Second, the subsection is amended to replace the existing reference to "designated stock exchange" with "stock exchange". This change is consistent with the commitment in the 2007 federal budget to review the appropriateness of using alternatives to the term "designated stock exchange" in the provisions of the Act. This change is made in new paragraph 137(4.1)(*b*).

Third, the subsection is amended to provide that, in determining whether an amount – paid or payable by a particular credit union in respect of a share of the particular credit union to a holder of the share – is treated as interest, the shareholder will be treated the same as a member of the particular credit union if the shareholder is a member of another credit union, the share is issued by the particular credit

union after March 28, 2012, and the other credit union is a member of the particular credit union. This change is reflected in new subparagraph 137(4.1)(*c*)(ii).

This amendment applies to the 2012 and subsequent taxation years.

Clause 63

Mark-to-market property

ITA
142.2(2)

The definition “mark-to-market property” in subsection 142.2(1) of the Act excludes, through the definition “excluded property” in subsection 142.2(1), a share of a corporation in which a taxpayer has a significant interest. Subsections 142.2(2) to (4) contain the definition “significant interest” and related rules.

Prior to various amendments made to section 142.2 by S.C. 2009, c. 2, the definition “mark-to-market property” had a reference to “significant interest” and section 142.2 contained subsection 142.2(5). Under those amendments (which were consequential on changes in accounting rules), the definition “mark-to-market property” was modified to remove the reference to a share of a corporation in which a taxpayer has a significant interest and the reference was incorporated into the new definition “excluded property” referred to above. In addition, subsection 142.2(5) was repealed.

Accordingly, subsection 142.2(2) is amended to remove references to the definition “mark-to-market property” and subsection 142.2(5).

This amendment comes into force on Royal Assent.

Clause 64

Reasonable error

ITA
147.1(19)

Section 147.1 of the Act sets out rules related to registration and administration of pension plans. New subsection 147.1(19) is added to permit administrators of registered pension plans to refund to a contributor any amount that had been contributed to the plan as result of a reasonable error, if the payment is made no later than December 31 of the year following the year in which the contribution was made.

Subsection 147.1(19) supplements an existing provision in subparagraph 8502(*d*)(iii) of the *Income Tax Regulations*, which permits (without a time limit) a refund of contributions in order to avoid the revocation of plan registration.

Subparagraph 56(1)(*a*)(i) generally requires that the amount refunded be included in the income of the recipient taxpayer (the member of the plan or the employer, as the case may be) except where new clause 56(1)(*a*)(i)(G) applies to exempt the amount from income inclusion (i.e., the amount is refunded under subsection 147.1(19) of the Act or subparagraph 8502(*d*)(iii) of the *Income Tax Regulations*, and the original contribution amount is not deducted for the taxation year in which the refund is made or for any preceding taxation year).

For further information, see the commentary on clause 56(1)(*a*)(i)(G). Please note that provincial standards legislation in some provinces set out conditions under which refunds of errant contributions must be approved by the provincial regulator.

This amendment applies to contributions made on or after the later of January 1, 2014 and the day on which Royal Assent is received.

Clause 65

Policy dispositions

ITA
148

Section 148 of the Act provides rules for determining the income tax consequences from a disposition of an interest in a life insurance policy.

ITA
148(5)

Under section 148 of the Act, the surrender of an interest in a life insurance policy is typically treated as a disposition. Subsection 148(1) requires a taxpayer that disposes of an interest in certain life insurance policies to include in computing the taxpayer’s income for a taxation year the taxpayer’s net gain in respect of the interest. The net gain is computed as the difference between the proceeds of the disposition that the policyholder, beneficiary or assignee, as the case may be, was entitled to receive in the year in respect of the disposition and the adjusted cost basis to the policyholder of the interest immediately before the disposition.

Where subsection 148(1) applies to require an amount to be included in a policyholder’s income in respect of the full or partial surrender of an interest in a 10/8 policy, new subsection 148(5) applies to provide an offsetting deduction. The deduction under subsection 148(5) is available only in respect of such a disposition that occurs in the period (the transition period) after March 20, 2013 and before April 2014. The deduction is intended to alleviate the income tax consequences from a withdrawal of savings from a 10/8 policy made to repay a 10/8 borrowing or policy loan against the policy (i.e., a borrowing or policy loan described in the definition of “10/8 policy”). For further information, see the commentary on the new definition “10/8 policy” in subsection 248(1).

The maximum deduction available to the policyholder in respect of a disposition under subsection 148(5) is the least of three amounts:

- A specified portion of the amount included in the policyholder’s income for the year under subsection 148(1) in respect of the disposition. The specified portion is the amount of the gain included under subsection 148(1) that is attributable to an investment account under the policy (i.e., an investment account described in paragraph (*b*) of the definition “10/8 policy” in subsection 248(1) in respect of the policy);
- The amount that is the total of all payments, made in the transition period, that reduce the amount outstanding of 10/8 borrowings or policy loans in respect of the policy; and
- The amount that is the total of all amounts the policyholder is entitled to receive as a result of the disposition and that are paid during the transition period directly or indirectly out of an investment account under the policy (i.e., an investment account described in paragraph (*b*) of the definition “10/8 policy” in subsection 248(1) in respect of the policy).

To prevent double counting, the totals described above exclude amounts that have been included under subsection 148(5) in computing another total in respect of a deduction under that subsection by any taxpayer.

This amendment applies to taxation years that end after March 20, 2013.

Clause 66

Becoming or ceasing to be exempt

ITA
149(10)

Subsection 149(10) of the Act applies if, at a particular time, a corporation becomes or ceases to be exempt from tax under Part I of the Act on its taxable income (otherwise than by reason of the exemption for certain insurers in paragraph 149(1)(*t*)). Under paragraphs 149(10)(*a*) and (*b*), a new taxation year is considered to start at the particular time and the corporation's properties are deemed to have been disposed of at fair market value and reacquired at the particular time for the same amount. Paragraph 149(10)(*c*) provides that the corporation is, for specified purposes in the Act, treated as a new corporation, with the effect that a number of tax attributes of the corporation cannot be carried over across the change in tax status. Paragraph 149(10)(*d*) requires the corporation to realize in its taxation year that includes its change in status any accrued loss in respect of its cumulative eligible capital.

Subsection 149(10) is amended to extend its application to trusts that, after September 12, 2013, become or cease to be exempt from tax under Part I. For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

Clause 67

Assessment and reassessment

ITA
152(4)

Subsection 152(4) of the Act generally provides that the Minister of National Revenue may at any time assess tax and other amounts payable by a taxpayer for a taxation year, but may not reassess after the normal reassessment period for the year. The normal reassessment period is, in general, three years from the date of the initial assessment for most taxpayers and four years for public, foreign-controlled and mutual fund corporations. Subsection 152(4) includes exceptions that apply in certain circumstances.

New paragraph 152(4)(*b.1*) is added to permit the reassessment of a participant in a tax shelter, or reportable transaction, outside of the normal reassessment period if the information return required by subsection 237.1(7) or 237.3(2) in respect of the tax shelter or reportable transaction is not filed as and when required. In these circumstances, the reassessment may be made within three years of the date that the relevant information return is filed.

New paragraph 152(5)(*b.2*) is added to permit the reassessment of a taxpayer outside of the normal reassessment period if the taxpayer has failed to report income from a specified foreign property on their annual income tax return and

- the Foreign Income Verification Statement (Form T1135) was not filed on time by the taxpayer (or by a partnership of which the taxpayer is a member), or
- a specified foreign property was not identified, or was improperly identified, on the Form T1135.

In these circumstances, the reassessment period is extended by three years.

Paragraph 152(4)(*c*) permits a reassessment outside of the normal reassessment period where a taxpayer has filed a waiver in prescribed form within the additional three-year period referred to in paragraph 152(4)(*b*). Paragraph 152(4)(*c*) is amended to also permit a reassessment outside of the normal reassessment period where the taxpayer has filed a waiver in prescribed form within the additional three-year period referred to in paragraph 152(4)(*b.1*). New paragraph 152(4)(*c.1*) permits the reassessment of a taxpayer outside of the normal reassessment period where the taxpayer has filed a waiver in prescribed form within the additional three-year period referred to in paragraph 152(4)(*b.2*).

The addition of paragraph 152(4)(*b.1*) and the reference to that paragraph in paragraph 152(4)(*c*) apply to taxation years that end after March 20, 2013.

The amendments to paragraphs 152(4)(*b.2*) and (*c.1*) apply to the 2013 and subsequent taxation years.

Assessment to which 152(4)(*a*), (*b*), (*b.1*) or (*c*) applies

ITA
152(4.01)

Subsection 152(4.01) of the Act limits the matters in respect of which the Minister of National Revenue can reassess when a reassessment to which paragraph 152(4)(*a*), (*b*) or (*c*) applies is made beyond the normal reassessment period for a taxpayer in respect of a taxation year.

Subsection 152(4.01) is amended to add references to new paragraph 152(4)(*b.1*), which allows for the reassessment of a participant in a tax shelter, or reportable transaction, outside of the normal reassessment period if the information return described in subsection 237.1(7) or 237.3(2) required in respect of the tax shelter or reportable transaction is not filed as and when required. As such, a reassessment of a liability for a taxation year, authorized to be made after the normal reassessment period by new paragraph 152(4)(*b.1*), is limited by new subparagraph 152(4.01)(*b*)(vii) to the deduction or claim in respect of the tax shelter or the tax benefit in respect of the reportable transaction.

This amendment applies to taxation years that end after March 20, 2013.

If waiver revoked

ITA
152(4.1)

Where a taxpayer has filed a waiver under subparagraph 152(4)(*a*)(ii) of the Act, subsection 152(4.1) of the Act limits the period during which the Minister of National Revenue may reassess a liability of the taxpayer, to six months after the taxpayer has notified the Minister of the revocation of the waiver. Subsection 152(4.1) is amended to make reference to a waiver referred to in new paragraph 152(4)(*c.1*).

This amendment applies to the 2013 and subsequent taxation years.

Clause 68

Instalments for individuals

ITA
156(4)

The income tax rules contain an instalment system that requires certain taxpayers to pay a portion of their estimated tax liability for a taxation year in instalments over the course of the year. Under section 156 of the Act, an individual may be required to pay quarterly tax instalments. This requirement is subject to certain exemptions in section 156.1.

SIFT trusts are currently subject to the instalment rules that apply to individuals. Under amendments to section 157, SIFT trusts will instead become subject to the instalment rules for public corporations. Subsection 156(4) is amended, consequential on the amendments to section 157, to provide that subsections 156(1) to (3) and section 156.1 do not apply to SIFT trusts.

This amendment applies to taxation years that begin after July 20, 2011. For further information, see the commentary on section 157.

Clause 69

Payment by corporation

ITA
157

Section 157 of the Act sets out the required payment dates for corporate income tax instalments and for any balance of corporate income tax payable. In general, a corporation is required to pay its tax liability for a taxation year in monthly instalments during the year as set out in subsection 157(1). However, subsection 157(1.1) allows small-Canadian-controlled private corporations (small-CCPCs) that meet the conditions set out in subsection 157(1.2) to pay their tax by quarterly, instead of monthly, instalments.

No longer a small-CCPC

ITA
157(1.5)

Subsection 157(1.5) of the Act sets out the rules for the monthly payment of tax by the corporation that previously qualified, as a small-CCPC, to pay quarterly tax instalments. The subsection in the English version of the Act is amended to correct two typographical errors.

Clause 157(1.5)(*a*)(ii)(B) of the English version of the Act is amended to correct a reference to "Parts VI and XIII.1". Paragraph 157(1.5)(*b*) of the English version of the Act is amended to correct a reference to "balance-due day".

Consistent with the introduction of subsection 157(1.5), these amendments apply to taxation years that begin after 2007.

Instalments for corporations

ITA
157(2)

The income tax rules contain an instalment system that requires certain taxpayers to pay a portion of their estimated tax liability for a taxation year in instalments over the course of the year. Section 157 of the Act sets out the required payment dates for corporate income tax instalments and for any balance of corporate income tax payable.

SIFT trusts are currently subject to the instalment rules that apply to individuals. These rules require, when they apply, that instalment payments be made on a quarterly basis. Public corporations, on the other hand, are generally required to make monthly instalment payments.

Subsection 157(2) is amended so that subsections 157(1), (2.1) and (4) apply to SIFT trusts with any modifications that the circumstances require. This ensures that SIFT trusts, like public corporations, make monthly instalment payments.

This amendment does not change the balance-due day of SIFT trusts, which is defined in subsection 248(1). In addition, any applicable regulations made pursuant to subsections 157(1), (2.1) and (4) – most notably section 5301of the *Income Tax Regulations* – apply to SIFT trusts in the same manner as they do to public corporations, with any modifications that the circumstances require.

This amendment applies to taxation years that begin after July 20, 2011.

Clause 70

Failure to provide claim preparer information

ITA
162(5.1) to (5.3)

New subsection 162(5.1) of the Act provides for a penalty of $1,000 in the case of false or incomplete information disclosure of the identity of, and the terms of any arrangement with, the claim preparer of an SR&ED form. In this regard, new subsection 162(5.3) sets out that, in general, an SR&ED form is a prescribed form required to be filed under subsection 37(11), and a claim preparer is a person or partnership that agrees to accept consideration to prepare, or assist in the preparation of, the form.

In particular, subsection 162(5.1) provides that any person or partnership who makes, or participates in, assents to or acquiesces in the making of, a false statement or omission in respect of claim preparer information required to be included in a form, that is required to be filed under subsection 37(11), is jointly and severally, or solidarily, liable with any claim preparer, who agrees to accept consideration to prepare, or assist in the preparation of, the form, to a penalty of $1,000.

Subsection 162(5.3) provides that a “claim preparer” is a person or partnership who agrees to accept consideration to prepare, or assist in the preparation of, an SR&ED form. An employee who prepares, or assists in the preparation of, an SR&ED form in the course of performing their employment duties is not a claim preparer. “Claim preparer information” is generally any prescribed information to be included in an SR&ED form regarding the identity of any claim preparer, and the arrangement under which the claim preparer agrees to accept consideration in respect of preparing, or assisting in the preparation of, the form.

New subsection 162(5.2) provides that a claim preparer will not be liable to the penalty if it is determined that the claim preparer has exercised the degree of care, diligence and skill to prevent the

making of the false statement or omission that a reasonably prudent person would have exercised in comparable circumstances. This is commonly referred to as a “due diligence” defence. Whether a person has exercised the degree of care, diligence and skill required will be based on the facts and circumstances of each case. It is intended that the application of the due diligence defence for the purposes of subsection 162(5.1) be based on jurisprudence that applies in respect of similar defences for the purposes of other provisions of the Act.

These amendments come into force on the later of January 1, 2014 and the day on which these subsections receive Royal Assent.

Clause 71

Electronic suppression of sales – penalties

ITA
163.3

New section 163.3 of the Act provides for administrative monetary penalties in relation to electronic suppression of sales software or devices (ESS software) that are, or are intended to be, capable of being used in relation to records that are required to be kept under section 230 of the Act. These new penalties are in addition to other penalties that may be assessed under the Act, as well as penalties that may be assessed under the *Excise Tax Act*.

New subsection 163.3(1) defines the terms “electronic cash register”, “electronic suppression of sales device” and “service” for the purposes of section 163.3.

- “Electronic cash register” generally means an electronic device or computer system designed to record transaction data, or any other electronic point-of-sale system.
- “Electronic suppression of sales device” generally means a software program that falsifies the records of electronic cash registers or a hidden programming option in an electronic cash register that may be used to create a virtual second till or to, eliminate or manipulate transaction records in the electronic cash register.
- “Service” has the meaning assigned by subsection 123(1) of the *Excise Tax Act*. This term has, generally, a broad meaning covering anything other than property, money and a supply of services rendered by an employee to an employer.

New subsection 163.3(2) imposes a penalty on every person that uses ESS software or that under circumstances attributable to neglect, carelessness or wilful default, participates in, assents to or acquiesces in the use of ESS software. New subsection 163.3(3) imposes a penalty on every person that acquires or possesses ESS software or a right in respect of ESS software. Section 285.01 of the *Excise Tax Act* imposes similar penalties, which means that a person may be liable for penalties under these subsections as well as the penalty imposed under the *Excise Tax Act*. On the first assessment of a penalty under either the Act or the *Excise Tax Act*, the amount of the penalty under subsection 163.3(2) or (3) is $5,000. If the person has already been assessed a penalty in relation to ESS software under either Act, the penalty for any subsequent use, acquisition or possession by the person of ESS software is $50,000.

New subsection 163.3(4) imposes a penalty on every person that designs, develops, manufactures, sells, possesses for sale, offers for sale, or otherwise makes available ESS software. Section 285.01 of the *Excise Tax Act* imposes a similar penalty, which means that a person may be liable for penalties

under this subsection as well as the penalty imposed under the *Excise Tax Act*. On the first assessment of a penalty, under the Act or the *Excise Tax Act,* the amount of the penalty is $10,000. If the person has already been assessed a penalty in relation to the manufacturing or making available of ESS software under either Act, the amount of the penalty is $100,000. If it is the first assessment of a penalty in relation to the manufacturing or making available of ESS software, but another penalty in relation to the use, acquisition or possession of ESS software has previously been imposed under either Act, the amount of the penalty is $50,000.

New subsection 163.3(5) allows the Minister of National Revenue to assess a taxpayer at any time in respect of any penalty payable under subsections 163.3(2) to (4).

New subsection 163.3(6) clarifies the limitations that apply with respect to the assessment of multiple penalties under subsections 163.3(2) to (4). This subsection provides that if the Minister assesses a penalty under subsections 163.3(2) to (4), the Minister is not to assess another penalty in respect of an action that relates to ESS software that occurred before that penalty was assessed.

New subsection 163.3(7) provides that, unless specifically provided by new subsection 163.3(8), a due diligence defence is not available in relation to penalties imposed under subsection 163.3(2) to (4). New subsection 163.3(8) provides that, in the case of penalties imposed under new subsections 163.3(3) and (4), a person is not liable in respect of an action of the person if the person exercised the degree of care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances to prevent that action from occurring.

New subsection 163.3(9) provides that, for the purpose of applying new subsections 163.3(2) to (8), if an assessment of a penalty under subsections 163.3(2) to (4) is vacated, the penalty is deemed to have never been assessed. This would mean, for example, that if an assessment of a penalty is vacated, that assessment would no longer trigger the limitation provided for in new subsection 163.3(6).

New section 163.3 comes into force on the later of the day on which the section receives Royal Assent and January 1, 2014.

Clause 72

SIFT partnerships

ITA
197(6)

Subsection 197(6) of the Act provides that certain provisions of Part I of the Act applicable to individuals and relating to assessments, payments and appeals are applicable to Part IX.1, with any modifications that the circumstances require.

Consequential on the amendments to section 156 and 157, subsection 197(6) is amended to replace the references to sections 156 and 156.1 with references to subsections 157(1), (2.1) and (4). This ensures that SIFT partnerships are subject to the same monthly instalment rules that apply to public corporations in respect of any Part IX.1 tax that is payable by a SIFT partnership.

This amendment does not change the SIFT partnership balance-due day as defined in subsection 248(1). In addition, any applicable regulations made pursuant to subsections 157(1), (2.1) and (4) – most notably section 5301 of the *Income Tax Regulations* – apply to SIFT partnerships in the same manner as they do to public corporations, with any modifications that the circumstances require.

This amendment applies to taxation years that begin after July 20, 2011.

Clause 73

Conditions for registration

ITA
204.81(1)

Section 204.81 of the Act sets out the conditions for the registration of labour-sponsored venture capital corporations (LSVCCs). Subsection 204.81(1) permits the Minister of National Revenue to register a corporation as an LSVCC under Part X.3 of the Act if its articles satisfy specified conditions and certain other requirements are met. Concurrent with the phase-out of the labour-sponsored funds tax credit, subsection 204.81(1) is amended to prevent the new registration of an LSVCC if the application for registration was received by the Minister after March 20, 2013.

Clause 74

Taxes in respect of certain registered plans

ITA
207.01

Budget 2011 extended certain special taxes on “advantages” and “prohibited investments” that apply in respect of tax-free savings accounts (TFSAs) to registered retirement savings plans (RRSPs) and registered retirement income funds (RRIFs). On June 12, 2012, the Department of Finance issued a letter to the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants (the “Joint Committee letter”) in which the Department agreed to recommend certain relieving and clarifying changes to the advantage and prohibited investment rules in Part XI.01 of the Act. The changes described below reflect the recommendations included in the Joint Committee letter, as well as certain other relieving and technical changes to Part XI.01. In general, these amendments to section 207.01 apply from March 23, 2011, the effective date of the extension of Part XI.01 to RRSPs and RRIFs. Any differing effective dates are noted below.

Definitions

ITA
207.01(1)

Subsection 207.01(1) of the Act provides definitions that are relevant for the purposes of special taxes that may apply in respect of TFSAs, RRSPs and RRIFs. The introductory portion of subsection 207.01(1) is amended consequential on the introduction of the definition “excluded property” in subsection 207.01(1), and the related repeal of Part L of the *Income Tax Regulations*, to remove the reference to Part L. In addition, the definitions “equity” and “transitional prohibited property” are introduced, and several existing definitions are amended, as a consequence of the Joint Committee letter.

“advantage”

Amounts described in the definition “advantage” are subject to a special tax under section 207.05 equal to their fair market value. The definition “advantage” is amended in three respects. First, a new exception is created in paragraph (*a*) of the definition to accommodate reasonable incentive programs frequently offered by plan issuers, investment dealers, and investment managers, as long as these programs are offered to a broad class of persons in a normal commercial or investment context and not established mainly for tax purposes. It is anticipated that this exception will accommodate

conventional, widely-offered promotional incentives – such as modest fee rebates or favourable rates of return – which could be viewed as conditional on the existence of a registered plan (for example, where customers are able to obtain more favourable treatment by having more than one product with a particular issuer).

Second, clause (*b*)(i)(A) of the definition "advantage" is amended to replace the reference to "open market" with "a normal commercial or investment context", consistent with the Joint Committee letter, to address concerns that the phrase "open market" could be interpreted very narrowly. Finally, paragraph (*c*) of the definition "advantage" is amended to make the description of income and capital gains more consistent with similar usage elsewhere in the Act, and to clarify that the dividend gross-up is not included in the amount of an advantage that is a dividend.

"equity"

To facilitate the new exclusion from the concept "prohibited investment" described in the Joint Committee letter, the new definition "equity" is added to subsection 207.01(1). The definition is similar to the existing definition of the same term in subsection 122.1(1). Like the subsection 122.1(1) definition, it includes trust and partnership interests as well as shares in a corporation. Unlike the subsection 122.1(1) definition, it does not include debt, or rights to acquire shares or other interests described in the definition.

The definition "equity" is used in the new definition "excluded property", which is a category of property that is excluded from being a prohibited investment.

"excluded property"

The new definition "excluded property" describes registered plan investments that are excluded from being prohibited investments for the TFSA, RRSP or RRIF that holds it. The new definition replaces, and expands on, prescribed excluded property as defined in existing section 5000 of the *Income Tax Regulations*, which is repealed. There are three categories of "excluded property" and they are set out in paragraphs (*a*), (*b*) and (*c*) of the new definition.

Certain insured mortgages

New paragraph (*a*) of the definition "excluded property" refers to property described in paragraph 4900(1)(*j*.1) of the *Income Tax Regulations*. Paragraph 4900(1)(*j*.1) describes certain insured mortgages. This category of excluded property was previously found in paragraph 5000(*a*) of the *Income Tax Regulations*.

Investment fund start-up and wind-up

New paragraph (*b*) of the definition "excluded property" replaces and broadens the existing exclusion in paragraph 5000(*b*) of the *Income Tax Regulations*. It provides that specific equity in certain investment vehicles (in these notes referred to as "funds") during the 24-month period on start-up or wind-up is considered "excluded property" and therefore is not subject to the prohibited investment rules. To qualify under new paragraph (*b*), a fund must be a mutual fund corporation, a mutual fund trust or a registered investment (as defined in the Act) and must meet the three conditions in subparagraphs (i), (iii) and (iv) of paragraph (*b*). Clauses (*b*)(ii)(A) and (B) provide 24-month periods for the start-up and wind-up of a fund. Clause (*b*)(ii)(C) accommodates the establishment of a new mutual fund by a previously incorporated mutual fund corporation (i.e., as a separate class of shares of the mutual fund corporation), as well as the termination of a mutual fund prior to the wind-up of a mutual fund corporation.

Subparagraph (*b*)(i) requires that the fund either be an NI 81-102 fund (i.e., a fund that is subject to, and substantially complies with, the requirements of *National Instrument 81-102 Mutual Funds* of the Canadian Securities Administrators) or that the fund follow a reasonable policy of investment diversification. This latter rule is intended to be a reasonably flexible test that will avoid both the risk of disqualifying a fund for minor breaches of, for example, a percentage test, and the need for potentially complex carve-outs and timing rules. At the same time, it is expected that if one of the main purposes of establishing the fund is to facilitate unintended tax avoidance, the fund would have difficulty satisfying this test.

In this regard, subparagraph (*b*)(iii) provides an explicit requirement that it be reasonable to conclude that none of the main purposes of the fund be to engage in the general types of tax planning that are targeted by the rules in Part XI.01 of the Act. These types of planning (which, depending on the type of registered plan and the profile of the investor, are either designed to divert or stream income or gains into plans, or, conversely, to devalue plans to avoid an income inclusion as amounts are withdrawn) can generally be described as affecting the fair market value of property held by the registered plans in a manner that would not occur in a normal commercial or investment context.

Subparagraph (*b*)(iv) is also an anti-avoidance rule. Its main purpose is to forestall the establishment of funds on a temporary basis (i.e., approximately four years) with a view to attempting to benefit from the exception provided by paragraph (*b*). It could also apply to a longer-term fund if the facts (for example, a relatively short life span for the fund in combination with a period of comparative inactivity in the middle years of the fund) suggest that one of the main purposes of the structure is to exploit the exception.

Alternative widely-held test

New paragraph (*c*) of the definition “excluded property” provides a carve-out from the prohibited investment rules for equity that meets seven conditions, which, in effect, test whether an investment represents a low risk of self-dealing even though the investment would or might otherwise be a prohibited investment. The paragraph refers to the equity-issuing entity as the “investment entity” and refers to equity (as defined in new subsection 207.01(1)) held by persons who deal at arm’s length with the controlling individual of the registered plan as “arm’s length equity”.

New subparagraph (*c*)(i) requires that the fair market value of the arm’s length equity must equal at least 90% of the fair market value of all the equity of the investment entity. This provision is intended to ensure that the controlling individual – while technically holding what would otherwise be a prohibited investment – is respecting the policy intent of the prohibited investment concept in terms of equity value.

New subparagraph (*c*)(ii) is a very similar 90%-of-value-at-arm’s-length test to the test in new subparagraph (*c*)(i), except that it applies to both equity and debt of the investment entity.

New subparagraph (*c*)(iii) prohibits the controlling individual, either alone or together with persons with whom the controlling individual does not deal at arm’s length, from having the right to cast at least 10% of the votes, if any, that could be cast regarding the governance of the investment entity.

New subparagraph (*c*)(iv) requires that the terms and conditions that apply to the equity in the investment entity held by the registered plan be the same as, or substantially similar to, the terms and conditions of at least some of the arm’s length equity (referred to in the provision as the “particular equity”).

New subparagraph (*c*)(v) relates to the "particular equity" referred to in new subparagraph (*c*)(iv). That is, it deals with the arm's length equity that has terms and conditions that are the same as, or substantially similar to, those of the investment held in the registered plan. New subparagraph (*c*)(v) requires that the particular equity be worth at least 10% of the fair market value of all the equity of the investment entity that has those substantially similar terms and conditions. The intention of this provision is to ensure that arm's length persons (in relation to the controlling individual) have a larger-than-nominal portion of the style and type of equity held in the controlling individual's registered plan.

New subparagraph (*c*)(vi) requires that the controlling individual deal at arm's length with the investment entity. Similarly, new subparagraph (*c*)(vii) functions effectively as an anti-avoidance rule in relation to the other conditions in paragraph (*c*). Specifically, new subparagraph (*c*)(vii) requires that it be reasonable to conclude that none of the main purposes of the structure of the investment entity or the terms and conditions of the equity is to accommodate transactions or events that could affect the fair market value of property held in the registered plan in a manner that would not occur in a normal commercial or investment context in which people deal with each other at arm's length and act prudently, knowledgeably and willingly. (Depending on the type of registered plan and the age of the controlling individuals, tax planning arrangements may seek to stream income or gains into a registered plan, in effect circumventing the contribution limits for the plan, or may instead seek to reduce the fair market value of plan assets in an effort to avoid or reduce RRIF minimum withdrawal requirements.)

"exempt contribution"

In general terms, an exempt contribution is a TFSA contribution made by an individual (the survivor) with proceeds received from an arrangement that was the TFSA of the survivor's deceased spouse. The definition is amended to allow the Minister of National Revenue to extend the time within which the survivor must designate the contribution as an exempt contribution.

"prohibited investment"

The holding of a prohibited investment in a registered plan generally results in a liability for tax under section 207.04. The definition is amended, consequential on the introduction of the definition "excluded property" in subsection 207.01(1), to remove the word "prescribed". Section 5000 of the *Income Tax Regulations*, which currently lists what constitutes prescribed excluded property, is repealed and its provisions are added to the new definition "excluded property". The definition "prohibited investment" is also amended to clarify that excluded property is excluded property for a particular trust governed by a registered plan.

Subparagraph (*b*)(ii) of the definition is amended to eliminate the phrase "or with a person or partnership described in subparagraph (i)". This relieving change was included in the Joint Committee letter and it has the effect of reducing the likelihood that an individual would have a prohibited investment in circumstances where the connection between the investment and the individual is less direct.

In order to ensure consistency with the original coming-into-force provision for the definition "prohibited investment", this amendment applies after March 22, 2011 in respect of investments acquired at any time.

"RRSP strip"

An RRSP strip, in general terms, is a transaction that, contrary to the intent of the RRSP and RRIF rules, seeks to remove or devalue RRSP or RRIF assets without an income inclusion for the annuitant.

The portion of the definition before the list of exceptions in paragraphs (*a*) to (*d*) is re-worded to better target transactions in which there is an actual reduction in the value of property held in connection with an RRSP or RRIF. The amended wording is also more consistent with the wording of the definition "RCA strip" in subsection 207.5(1).

Because of this re-wording, paragraph (*d*) of the definition is also repealed; it is no longer needed to preserve the ability to hold the insured mortgages referred to in that paragraph in an RRSP or RRIF. (Under the previous wording, the exception was necessary because such a mortgage could have been considered the use of an RRSP or RRIF's funds without an RRSP or RRIF income inclusion). The repeal of paragraph (*d*) also clarifies that the RRSP strip definition could apply to insured mortgages that do in fact seek to remove or devalue the RRSP or RRIF assets without an income inclusion for the annuitant.

"specified non-qualified investment income"

In general terms, an amount is specified non-qualified investment income if it is second or subsequent generation income (or a capital gain) earned (or realized) on non-qualified investment income or on income from a business carried on by a registered plan (i.e., a TFSA, RRSP or RRIF). Under subsection 207.06(4), the Minister of National Revenue may issue a notice requiring the removal from a registered plan of an amount equal to the plan's specified non-qualified investment income, failing which, the amount will be considered an advantage. The definition "specified non-qualified investment income" is amended to make the description of income and capital gains more consistent with similar usage elsewhere in the Act, and to clarify that the dividend gross-up is not included in the amount of an advantage that is a dividend.

"swap transaction"

A "swap transaction" is, in general terms, a transfer of property between a controlling individual of a registered plan (or a person with whom the controlling individual does not deal at arm's length) and a registered plan of the individual. It is subject to certain exceptions listed in the paragraphs in the definition. The exception in paragraph (*c*) of the definition, which is intended to facilitate the removal of a prohibited or non-qualified investment from a registered plan, is amended, consistent with the Joint Committee letter, to clarify that consideration paid to the registered plan (and not just the removal of the investment) is part of the excluded transaction and that as a consequence neither side of the transaction is a swap transaction. In addition to clarifying the intended operation of paragraph (*c*), the following paragraphs are added to the definition:

- New paragraph (*e*) is added consequential on the introduction of subsections 207.01(12) and (13), and provides that the definition does not apply in respect of a transfer of a prohibited investment from a registered plan for consideration, if subsection 207.01(13) applies in respect of all or part of the consideration (i.e., non-cash consideration) received by the registered plan in respect of the transfer.
- New paragraphs (*f*) and (*g*) are added to clarify that both the transfer of property from a registered plan in consideration for the issuance of a debt obligation that is an excluded property for the plan (generally insured mortgages), and the payment into the plan of the principal amount of, or interest on, the debt obligation, are not considered "swap transactions".

In order to ensure consistency with the original coming-into-force provision for the definition "swap transaction", these amendments come into force on July 1, 2011, except that they do not apply in

relation to a swap transaction undertaken before 2022 to remove a property from an RRSP or RRIF if it is reasonable to conclude that tax would be payable under Part XI.01 of the Act if (i) that Part were read without reference to the transitional relief available under subsection 207.05(4), and (ii) the property were retained in the RRSP or RRIF.

"transitional prohibited investment benefit"

The definition "transitional prohibited investment benefit" generally refers to income from, or a capital gain on, a prohibited investment held by an RRSP or RRIF on March 23, 2011. A transitional prohibited investment benefit is eligible for relief from the advantage tax. Where income (or all or a portion of a realized capital gain) meets this definition, subsection 207.05(4) allows a taxpayer to elect not to have the advantage tax apply in respect of the income or gain as long as the amount of the income or gain is withdrawn from the taxpayer's RRSP or RRIF.

The definition "transitional prohibited investment benefit" is amended in three respects. First, similar to changes described above in relation to the definitions "specified non-qualified investment income" and "advantage", the definition is amended to clarify that the dividend gross-up is not included in the amount of an advantage that is a dividend. Second, the definition is amended to clarify that the transitional prohibited investment benefit for a calendar year includes only income or capital gains attributable to a prohibited investment held by an RRSP or RRIF on March 23, 2011 that continues to be a prohibited investment for the taxpayer's registered plans (i.e., income or capital gains considered to be an "advantage" under subparagraph (*c*)(i) of that definition). Third, consistent with the Joint Committee letter, the requirement that the income or capital gain must be earned or realized, as the case may be, before 2022 is eliminated.

"transitional prohibited property"

The new definition "transitional prohibited property" is introduced to describe property held by an individual's RRSP or RRIF at a particular time, if the property was also held by an RRSP or RRIF of the individual on March 22, 2011 and was a prohibited investment for that RRSP or RRIF on March 23, 2011.

Significant interest

ITA
207.01(4)(*a*)

Subsection 207.01(4) sets out the circumstances in which an individual is considered to have a significant interest in a corporation, partnership or trust. The subsection applies for the purposes of the tax imposed under subsection 207.04(1) on the holding of prohibited investments by a registered plan, as well as the advantage tax imposed under subsection 207.05(1) in respect of any income earned or capital gain derived from those investments.

Paragraph 207.01(4)(*a*) provides that an individual has a significant interest in a corporation at a particular time if the individual is a "specified shareholder" at that time (within the meaning assigned by subsection 248(1)). In general terms, a person is a "specified shareholder" of a corporation, as defined in subsection 248(1), at a particular time in a taxation year, if the person owns, directly or indirectly, at least 10% of the issued shares of any class of the capital stock of the corporation or a related corporation at any time in the year.

Paragraph 207.01(4)(*a*) is amended to provide that an individual has a significant interest in a corporation at a particular time if the individual would, at that time, be a specified shareholder of the

corporation if the references in the portion of the definition "specified shareholder" in subsection 248(1) before paragraph (*a*) to "in a taxation year" and "at any time in the year" were read as "at any time" and "at that time", respectively. The amendment clarifies that the determination of whether an individual has a specified interest in a corporation at a particular time is to be made based on an examination of the shares of the corporation (and corporations related to it) that are owned, directly or indirectly, by the individual at that time, and not at any other time. For example, if an individual owned 10% of the issued shares of the only class of shares of a corporation on March 1, 2013, but only owned 5% of the issued shares on June 1, 2013, the individual would be considered to have a significant interest in the corporation on March 1, 2013, but not on June 1, 2013.

This amendment comes into force on January 1, 2009.

Deemed disposition and reacquisition of investments and deemed adjusted cost base

ITA
207.01(6) and (7)

New subsection 207.01(6) of the Act provides a deemed disposition rule for property that becomes, or ceases to be, a non-qualified investment or prohibited investment. More specifically, subsection 207.01(6) provides that a property held by a registered plan is deemed to have been disposed of immediately before the time that it became, or ceased to be, a non-qualified investment or a prohibited investment for proceeds of disposition equal to the property's fair market value. The registered plan is also deemed to have reacquired the property for the same amount at the time of its change in status. This provision replaces existing subsection 207.04(5), which only applied when a property ceased to be a non-qualified investment or prohibited investment.

New subsection 207.01(7) provides a related rule that deals specifically with the effective date for the extension of the advantage and prohibited investment rules to RRSPs and RRIFs. New subsection 207.01(7) deems the cost of a "pre-budget" prohibited investment (that is, a transitional prohibited property for the trust) to be equal to its fair market value on March 22, 2011. This provision, which is consistent with the Canada Revenue Agency's existing administrative practice, clarifies the calculation of capital gains and losses accruing after March 22, 2011 for purposes of the definition "transitional prohibited investment benefit" and the transitional relief available under subsection 207.05(4).

Prohibited investment status

ITA
207.01(8) and (9)

New subsections 207.01(8) and (9) allow the controlling individual of an RRSP or RRIF to make an election in certain circumstances in respect of property held by the RRSP or RRIF that would, in the absence of such an election, cease to be a prohibited investment at a particular time (the "relevant time") and therefore be subject to the deemed disposition rule in new subsection 207.01(6). If no election is made and the deemed disposition under subsection 207.01(6) results in a capital gain, the controlling individual would be subject to the advantage tax or be forced to withdraw the gain from the RRSP or RRIF to take advantage of the transitional relief available under subsection 207.05(4) even though the RRSP or RRIF did not receive any actual proceeds of disposition in respect of the property.

Subsection 207.01(9) applies in respect of the property if all of the following conditions (set out in subsection 207.01(8)) are satisfied:

- the property would, in the absence of subsection 207.01(9), have ceased at the relevant time to be a prohibited investment for a trust governed by an RRSP or RRIF of the controlling individual;
- the property is a transitional prohibited property for the trust immediately before the relevant time;
- the controlling individual elected under subsection 207.05(4); and
- the controlling individual elects in prescribed form that subsection 207.01(9) apply in respect of the property and the election is filed with the Minister of National Revenue on or before the day that is 90 days after the end of the taxation year of the controlling individual that includes the relevant time.

If subsection 207.01(9) applies in respect of the property, the property is deemed to be a prohibited investment at and after the relevant time for every trust governed by an RRSP or RRIF of the controlling individual, with the result that the deemed disposition rule in subsection 207.01(6) would not be triggered at the time the property ceased to be a prohibited investment.

Subsections 207.01(8) and (9) come into force on March 23, 2011. An election referred to in paragraph 207.01(8)(*d*) will be deemed to have been filed with the Minister of National Revenue on a timely basis if it is filed on or before the day that is 90 days after the day on which these amendments receive Royal Assent.

Breakdown of marriage or common-law partnership

ITA
207.01(10) and (11)

New subsections 207.01(10) and (11) are added to allow the controlling individual of an RRSP or RRIF and their current or former spouse or common-law partner to make a joint election in certain circumstances in respect of property that is transferred directly to the controlling individual's RRSP or RRIF from the RRSP or RRIF of the current or former spouse or common-law partner in accordance with the tax-free transfer rule in paragraph 146(16)(*b*) or subsection 146.3(14). The issue that these new subsections address is set out in the following excerpt from a Department of Finance comfort letter dated July 9, 2013:

> *You have expressed concern that, under the existing legislation, the tax consequences under Part XI.01 of the Act to both the individual and his spouse would not be appropriate in tax policy terms, and would undermine what you consider is the clear policy intent of paragraph 146(16)(b) and subsection 146.3(14) of the Act to not penalize parties financially where spouses or former spouses are required to reallocate assets between their RRSPs as a result of their marriage breakdown. In the absence of any amendments, the tax consequences under Part XI.01 to the individual and his spouse can be summarized as follows:*
>
> - *the subject units will be prohibited investments for the trust governed by the individual's RRSP, but will not constitute grandfathered property to the trust, such that*
>
>   *(i)* *the individual will be subject to the tax payable under subsection 207.04(1) of the Act, equal to 50% of the fair market value of the subject units at the time they are acquired by the trust, and*

(ii) *the individual will be subject to the 100% advantage tax in respect of any income earned, or capital gains realized, by the trust in respect of the subject units, as the transitional prohibited investment benefit election in subsection 207.05(4) would not apply to the individual in respect of the subject units; and*

- *the spouse will be subject to the 100% advantage tax in respect of the capital gain, if any, realized by the trust governed by her RRSP on the transfer of the subject units, unless an amount equal to her transitional prohibited investment benefit for the taxation year that includes the transfer is paid out of the trust (or any other RRSP under which she is the annuitant) within 90 days after the end of that year and included in her income as a regular RRSP withdrawal.*

In this context, we agree that it would be appropriate to allow, on an elective basis, for the preservation of grandfathered property status for property that has been transferred from an individual's RRSP, on behalf of the individual and in accordance with paragraph 146(16)(b) or subsection 146.3(14) of the Act, to an RRSP of the individual's current or former spouse or common-law partner.

We are therefore prepared to recommend to the Minister of Finance amendments to the Act which would allow an individual (the "transferor") and their current or former spouse or common-law partner (the "recipient") to make and file a joint election in respect of a particular property if the following conditions are satisfied:

- *the property is transferred from a trust (the "transferor trust") governed by an RRSP of the transferor, on behalf of the transferor in accordance with paragraph 146(16)(b) or subsection 146.3(14) of the Act, to a trust (the "recipient trust") governed by an RRSP under which the recipient is the annuitant;*
- *the property is grandfathered property for the transferor trust immediately before the transfer;*
- *the transferor made a timely-filed election described in subsection 207.05(4) of the Act; and*
- *the transferor and the recipient designate an amount in respect of the property in the election, where the amount*

(i) *is not less than the adjusted cost base to the transferor trust of the property at the time of the transfer, and*

(ii) *does not exceed the greater of the amount determined in (i) and the fair market value of the property at the time of the transfer.*

If a joint election has been made by the transferor and the recipient, and the conditions set out above are satisfied, the following would result:

- *the property will be deemed to be a prohibited investment for any trust governed by an RRSP of the recipient which holds the property;*
- *the recipient will not be subject to the 50% tax payable on prohibited investments imposed under subsection 207.04(1) of the Act in respect of the holding or acquiring of the property by [any trust governed by an RRSP of the recipient];*

- *the property will be deemed to be a grandfathered property for [any trust governed by an RRSP of the recipient] and the recipient will be deemed to have made a valid election under subsection 207.05(4) of the Act, such that the recipient will be eligible for the transitional relief available under that subsection;*
- *the amount designated in respect of the property by the transferor and the recipient in the election will be deemed to be*

(i) *the transferor trust's proceeds of disposition in respect of the transfer of the property (such that the capital gain, if any, resulting on the transfer will be subject to the transitional relief available under subsection 207.05(4) of the Act), and*

(ii) *the cost of the property to the recipient trust.*

Subsections 207.01(10) and (11) come into force on March 23, 2011. An election referred to in paragraph 207.01(10)(*d*) will be deemed to have been filed with the Minister of National Revenue on a timely basis if it is filed on or before the day that is 90 days after the day on which these amendments receive Royal Assent.

Exchange of property

ITA
207.01(12) and (13)

New subsections 207.01(12) and (13) are added to extend the transitional relief from the prohibited investment and advantage rules that are afforded to transitional prohibited property held by a trust governed by an individual's RRSP or RRIF to non-cash property acquired by the trust in the course of certain permitted reorganization or exchange transactions; namely, a transaction to which any of section 51, subsection 85(1) and sections 85.1, 86 and 87 apply. The issue that these new subsections address is set out in the following excerpt from a Department of Finance comfort letter dated February 12, 2013:

> *As further explained in your letter, Pubco has announced that it intends to proceed with a reorganization of its share capital under a transaction designed to comply with the "butterfly" rules in section 55 of the Act. Immediately following the transaction, each Pubco shareholder will hold shares of Pubco and a new corporation ("Pubco II") equal in value to the value of Pubco shares held by that shareholder immediately prior to the transaction. The relevant steps of the transaction will include:*
>
> *(i)* *a reorganization of the capital of Pubco pursuant to which Pubco shareholders will have their existing Pubco shares converted, on a tax- deferred basis under section 86 of Act, into new classes of Pubco shares of equivalent value;*
>
> *(ii)* *the subsequent transfer, on a tax-deferred basis (i.e., under section 85 or 85.1 of the Act), by Pubco shareholders of Pubco shares to Pubco II in exchange for Pubco II shares of equivalent value; and*
>
> *(iii)* *the amalgamation of Pubco II with an affiliated corporation as part of the transaction, following which the newly-formed corporation will be listed on a designated stock exchange in Canada.*
>
> *You have expressed concern that, under the existing legislation, the new shares of Pubco and Pubco II will not be grandfathered property for the controlling individual's RRIF. Though*

not explicitly stated, we infer that the shares of Pubco and Pubco II will be prohibited investments for the trust at the time they are acquired. Accordingly, the controlling individual will be subject to the 50% tax payable on prohibited investments under subsection 207.04(1) of the Act in respect of each share acquisition described above, and is unlikely to satisfy the conditions for a refund of the tax provided for under subsection 207.04(4) of the Act. Furthermore, the transitional prohibited investment benefit election in subsection 207.05(4) would not apply to the controlling individual in respect of the shares of Pubco and Pubco II acquired by the trust in the course of the reorganization, such that the controlling individual would be subject to the 100% advantage tax imposed under subsection 207.05(1) of the Act in respect of any income or capital gain derived from those shares.

In this context, we agree that it would be appropriate to preserve grandfathered property status for shares received by an individual's RRIF or RRSP on a share-for-share exchange involving grandfathered property in the course of a corporate re-organization as described above, where no non-share consideration is included in the transaction and where the exchange or exchanges occur on a fair market value basis. We are therefore prepared to recommend to the Minister of Finance amendments to the Act to exclude newly-received shares in these circumstances from the application of the tax on prohibited investments imposed under subsection 207.04(1) of the Act; and to expand the transitional relief available under subsection 207.05(4) of the Act by including the income earned, or capital gains realized, by a trust governed by an individual's RRIF or RRSP in respect of such shares in the calculation of the individual's transitional prohibited investment benefit.

It is important to note that the RRSP strip and other advantage provisions could apply in the context of a transaction that purported to benefit from these new grandfathering preservation rules if the facts of a given situation revealed that it involved a deliberate attempt to impair or, conversely, inflate, the fair market value of property held in one or more RRSPs or RRIFs.

No election is required to benefit from the extended transitional relief provided by new subsections 207.01(12) and (13), and any non-cash consideration received by the trust in the course of the reorganization or exchange transaction will automatically be deemed to be, at and after the time of the transfer, a prohibited investment for every trust governed by an RRSP or RRIF of the controlling individual. This deeming rule is required to ensure that taxpayers cannot deliberately structure a reorganization or exchange transaction in such a way that their RRSP or RRIF transfers or disposes of a transitional prohibited property that is a prohibited investment, tax-free, in exchange for a property that is not a prohibited investment, thereby circumventing the application of the advantage tax in respect the transfer or disposition of the prohibited investment, and the eligibility requirements for transitional prohibited investment benefit relief under subsection 207.05(4).

Clause 75

Tax payable on prohibited or non-qualified investment

ITA
207.04(1)

Subsection 207.04(1) of the Act imposes taxes on the controlling individual of a registered plan (i.e., the holder of a TFSA or the annuitant of an RRSP or RRIF) if a trust governed by the registered plan holds a non-qualified investment or a prohibited investment. Paragraph 207.04(1)(*b*), in particular,

provides that the controlling individual is liable for the tax when a property held by the trust becomes a prohibited investment, or a non-qualified investment, for the trust.

With the addition of new subsection 207.01(6) – which deems a trust governed by an RRSP or RRIF to dispose of, and immediately thereafter reacquire, property held by it that becomes a prohibited investment or non-qualified investment for the trust – paragraph 207.04(1)(*b*) has become redundant and is repealed.

This amendment comes into force on March 23, 2011.

Both prohibited and non-qualified investment

ITA
207.04(3)

Subsection 207.04(3) applies if property would otherwise be, at the same time, both a non-qualified investment and a prohibited investment. In those circumstances, the property is deemed to be a prohibited investment and not a non-qualified investment. Subsection 207.04(3) is amended to expand its application to new subsection 207.01(6).

This amendment comes into force on March 23, 2011.

Deemed disposition and reacquisition

ITA
207.04(5)

Subsection 207.04(5) provides a deemed disposition rule that applies where property ceases to be a non-qualified investment or a prohibited investment. Subsection 207.04(5) is repealed, consequential on the introduction of a more comprehensive deemed disposition rule in new subsection 207.01(6). For further information, please see the commentary on subsection 207.01(6).

This amendment comes into force on March 23, 2011.

Clause 76

Transitional prohibited investment benefit – filing rules

ITA
207.05(4)

Subsection 207.05(4) of the Act provides transitional relief from the advantage rules in respect of a "transitional prohibited investment benefit" (as defined in subsection 207.01(1)) if the amount is paid out of an RRSP or RRIF of the taxpayer within 90 days after the end of the relevant taxation year and if an election is filed in prescribed form. The deadline for filing this election (currently July 2012) is extended to March 2, 2013 so that taxpayers may determine whether they are affected by these amendments to Part XI.01.

Consistent with the extended deadline for filing the election, paragraph 207.05(4)(*b*) is amended to extend the deadline for paying the "transitional prohibited investment benefit" out of an RRSP or RRIF to the later of April 2, 2013 and the day that is 90 days after the end of the relevant taxation year.

These amendments come into force on March 23, 2011.

Clause 77

Waiver of taxes

ITA
207.06(2) and (3)

Section 207.06 of the Act allows the Minister of National Revenue, in certain circumstances, to waive all or part of any tax imposed under sections 207.02, 207.03 or 207.05 or subsection 207.04(1). Subsection 207.06(2) provides that tax liabilities under subsection 207.04(1) (the tax on prohibited or non-qualified investments) or section 207.05 (the advantage tax) may be waived or cancelled if the Minister considers it just and equitable to do so, having regard to all the circumstances. It also lists particular circumstances that should be considered.

Subsection 207.06(3) requires that, before the Minister may provide the waiver or cancellation, payments must be made without delay from a taxpayer's registered plan in an amount at least equal to the amount of the liability to be waived or cancelled. Consistent with the Joint Committee letter described above, subsection 207.06(3) is repealed. Instead new paragraph 207.06(2)(*c*) is added to the list of factors to be considered by the Minister and the paragraph refers to the making of payments from the taxpayer's registered plan.

This amendment comes into force on March 23, 2011.

Clause 78

TFSA income inclusion

ITA
207.061

Section 207.061 of the Act requires a holder of a Tax-Free Savings Account (TFSA) to include certain amounts in computing their income. Section 207.061 is amended, consequential on the amendments to subsections 207.06(2) and (3) described above, to remove the reference to subsection 207.06(3) and to instead require the inclusion in income of an amount specified by the Minister of National Revenue as part of an agreement to waive or cancel a liability for tax under Part XI.01.

This amendment comes into force on March 23, 2011.

Clause 79

Return and payment of tax

ITA
207.07(1)

Subsection 207.07(1) of the Act requires a person liable for tax under Part XI.01 to file a return for the calendar year and pay any tax owing (net of the person's allowable refund for the year) within 90 days after the end of the year.

To better coincide with the filing period for Part I returns, subsection 207.07(1) is amended to extend the deadline for filing Part XI.01 returns and paying the associated taxes to June 30th of the following year.

This amendment comes into force on Royal Assent.

Clause 80

“labour-sponsored funds tax credit”

ITA
211.7(1)

Subsection 211.7(1) of the Act provides definitions for the purposes of Part XII.5 of the Act. “Labour-sponsored funds tax credit” in respect of a share is defined as:

- if the original acquisition of the share occurred before 1996, 20% of the net cost of the share on that acquisition, and
- in any other case, the federal tax credit potentially available in respect of the acquisition of the share, ignoring the consideration limits set out in subsection 127.4(5).

For labour-sponsored venture capital corporations registered under Part X.3 of the Act, Part XII.5 levies a tax on the disposition of a share, which is essentially a recovery of the labour-sponsored funds tax credit in respect of the original acquisition of the share.

The definition “labour-sponsored funds tax credit” is amended consequential on the phase-out of the credit, in order to ensure that the appropriate penalty is applied to shares under Part XII.5 for years of acquisition where the labour-sponsored funds tax credit had been reduced, and to eliminate the penalty for years where the acquisition of the share did not benefit from the tax credit.

Specifically, paragraph (*b*) of the definition is amended for original acquisitions of shares after 1995 and prior to March 2, 2017, to calculate the tax credit as the federal tax credit potentially available in respect of the acquisition of the share based on the claim by the individual under subsection 127.4(2) in respect of the original acquisition of the share. New paragraph (*c*) is added to ensure that acquisitions on or after March 2, 2017 will result in a labour-sponsored funds tax credit of nil for the purposes of Part XII.5.

The amendment comes into force on March 21, 2013.

Clause 81

Tax for failure to reacquire certain shares

ITA
211.81

Section 211.81 of the Act provides for a matching federal tax when an individual is liable to pay a provincial tax, prescribed by regulation, in respect of an approved share of a labour-sponsored venture capital corporation (LSVCC). In this regard section 6709 of the *Income Tax Regulations* prescribes, for the purposes of section 211.81, the tax payable under Quebec’s *Taxation Act* for an individual who fails to acquire a new approved share of an LSVCC, after the individual has disposed of another approved share of an LSVCC for the purpose of investing the proceeds in a home buyers plan or a lifelong learning plan. The existing penalty under section 211.81 matches the penalty applicable under Quebec’s *Taxation Act.*

The federal penalty is amended so that it is equal to the federal tax credit that the individual received on the acquisition of the share.

This amendment comes into force on October 24, 2012, the time when the provision was first enacted.

Clause 82

Non-arm's length share sale by non-resident

ITA
212.1

Section 212.1 of the Act is an anti-avoidance rule designed to prevent the removal of taxable corporate surplus as a tax-free return of capital through a non-arm's length transfer by a non-resident of shares from one Canadian corporation to another Canadian corporation.

The references in the English version of section 212.1 to the term "majority interest partner" and "majority interest group of partners" are replaced with references to "majority-interest partner" and "majority-interest group of partners". These amendments are consequential on a similar amendment to the definition "majority-interest partner" in subsection 248(1). For further information, see the commentary on that definition.

These amendments come into force on Royal Assent.

Clause 83

Part XIII – non-resident withholding tax

Deemed payments

ITA
214(3)(*f*)

A beneficiary under a trust is required under subsection 104(13) of the Act to include in computing its income for a taxation year the part of the trust's income, for the trust's taxation year that ends in the beneficiary's year, that becomes payable in the trust's year to the beneficiary (referred to in this commentary as the "income amount").

If a trust is resident in Canada and a beneficiary under the trust is non-resident when the income amount is paid or credited to the beneficiary, the beneficiary is generally subject to Canadian withholding tax on the income amount by operation of paragraph 212(1)(*c*), read in conjunction with subsection 212(11). Paragraph 214(3)(*f*) deems such an income amount to be paid or credited to the beneficiary on the earlier of the day on which the amount is actually paid or credited and the day that is 90 days after the end of the trust's year, and not at any later time.

Paragraph 214(3)(*f*) is amended to ensure the proper application of Canadian withholding tax in circumstances in which an income amount becomes payable by a Canadian resident trust and the trust later becomes non-resident but before the income amount is actually paid or credited. Specifically, the paragraph will now deem the income amount to be paid or credited at the earliest of the times currently described in the paragraph and, if the trust's year ends after July 25, 2012 because of subsection 128.1(4), the time that is immediately before the end of the trust's year.

This amendment comes into force on July 25, 2012.

Clause 84

Branch tax

ITA
219(1)(*d*)(ii)

Subparagraph 219(1)(*d*)(ii) of the Act is amended to replace the cross reference to paragraph 115(1)(*e*) by a cross reference to paragraph 115(1)(*d*). This is consequential on the amendment of paragraphs 115(1)(*c*) to (*e*) by S.C. 1999, c.22, applicable to 1998 and subsequent taxation years.

This amendment applies to 1998 and subsequent taxation years.

ITA
219(1.1)

Subsection 219(1.1) of the Act is amended to replace the cross reference to paragraphs (*c*) to (*k*) of the definition "taxable Canadian property" by a cross reference to paragraphs (*c*) to (*e*) of that definition. The reference to paragraph (*l*) of the definition "taxable Canadian property" is replaced by a cross reference to paragraph (*f*) of the same definition. This is consequential on the amendment of the definition of taxable Canadian property by Budget 2010.

This amendment comes into force on March 5, 2010.

Clause 85

Disclosure of information

ITA
239(2.21)(*b*)

Subsection 239(2.21) of the Act makes it an offence for a person to whom taxpayer information has been provided for a particular purpose to knowingly use, or to allow the unauthorized use of, that information for any other purpose. This offence is punishable on summary conviction by a fine not exceeding $5,000, imprisonment for a term not exceeding 12 months or both. Paragraph 239(2.21)(*b*) is amended to add a reference to new paragraph 241(1)(*j.2*). This amendment ensures that with the concurrent repeal of subsection 122.64(4) (which provides for the same penalty), subsection 239(2.21) will be applicable in respect of information that was within the ambit of subsection 122.64(4).

This amendment comes into force on Royal Assent.

Penalty on conviction

ITA
239(3)

Subsection 239(3) of the Act provides that if a person is convicted of an offence under section 239, the person will not after that time be subject to a penalty under any of sections 162, 163 and 163.2 for the same action that led to the conviction. This subsection is amended to also apply to a person who would otherwise be subject to a penalty under new section 163.3.

This amendment comes into force on the later of the day on which the amendment receives Royal Assent and January 1, 2014.

Clause 86

Electronic suppression of sales – offences

ITA
239.1

New section 239.1 of the Act sets out offences in relation to electronic suppression of sales software or devices (ESS software) that are, or are intended to be, capable of being used in relation to records that are required to be kept under section 230 of the Act.

New subsection 239.1(1) provides that the definitions in subsection 163.3(1) of the Act apply in section 239.1. For more information, refer to the commentary for subsection 163.3(1).

New subsection 239.1(2) provides that every person is guilty of an offence if that person, without lawful excuse, the proof of which lies on the person,

(a) uses an electronic suppression of sales device (as defined in new subsection 163.3(1)) or a similar device or software in relation to records that are required to be kept under section 230,

(b) acquires or possesses an electronic suppression of sales device, or a right in respect of an electronic suppression of sales device, that is, or is intended to be, capable of being used in relation to records that are required to be kept under section 230,

(c) designs, develops, manufactures, possesses for sale, offers for sale, sells, transfers, or otherwise makes available to another person, an electronic suppression of sales device that is, or is intended to be, capable of being used in relation to records that are required to be kept under section 230,

(d) supplies installation, upgrade or maintenance services for an electronic suppression of sales device that is, or is intended to be, capable of being used in relation to records that are required to be kept under section 230, or

(e) participates in, assents to or acquiesces in the commission of, or conspires with any person to commit any of the foregoing.

In addition to any penalty otherwise provided, the person is liable on summary conviction, to a fine of not less than $10,000 and not more than $500,000, or to imprisonment for a term not exceeding two years, or to both.

New subsection 239.1(3) provides that, in respect of the offences described in subsection 239.1(2), the Attorney General of Canada may proceed by indictment. If convicted, the person is liable to a fine of not less than $50,000 and not more than $1,000,000, or to imprisonment for up to five years, or to both.

New subsection 239.1(4) provides that if a person is convicted of an offence under section 239.1, the person will not be liable to pay a penalty under any of sections 162, 163, 163.2 and 163.3 of the Act for the same action that led to the conviction. This general rule will not apply, however, if a notice of assessment in respect of the penalty was issued before the information or complaint giving rise to the conviction was laid or made.

New subsection 239.1(5) provides that the Minister may file with the Tax Court of Canada a stay of proceedings for an appeal under the Act of an assessment, pending the determination of a prosecution under section 239.1, where substantially the same facts are at issue in both instances.

New section 239.1 comes into force on the later of the day on which the section receives Royal Assent and January 1, 2014.

Clause 87

Disclosure of information

ITA
241(4)

Section 241 of the Act prohibits the use or communication of taxpayer information by any official or other representative of the government, except as authorized. Subsection 241(4) authorizes the communication of information for limited purposes.

ITA
241(4)(*d*)(ix)

Subparagraph 241(4)(*d*)(ix) permits the disclosure of the name, address, occupation and size or type of business of a person to a government department or agency for the purpose of enabling that department or agency to obtain statistical data for research and analysis.

Subparagraph 241(4)(*d*)(ix) is amended to add "telephone number" to the list of the types of data that may be disclosed. This amendment will conform the Act to the equivalent provision in the *Excise Tax Act*.

This amendment comes into force on Royal Assent.

ITA
241(4)(*d*)(x)

Subparagraph 241(4)(*d*)(x) allows information to be communicated to the Canada Employment Insurance Commission or the Department of Human Resources and Skills Development for the purposes of administering or enforcing the *Employment Insurance Act* or an employment program of the Government of Canada, or evaluating or developing policy for that Act or program. This subparagraph is amended to replace Department of Human Resources and Skills Development with the Department of Employment and Social Development to reflect the recent change to the name of the Department. This subparagraph is also amended to clarify that information may be communicated to the Department of Employment and Social Development for activities relating to a program for temporary foreign workers and for evaluating or developing policy for such a program.

This amendment comes into force on Royal Assent.

ITA
241(4)(*j.1*)

Paragraph 241(4)(*j.1*) authorizes the communication of information to an official or a designated person for the purpose of making adjustments to certain payments, including a payment pursuant to a prescribed law of a province. Consequential on the repeal of *An Act respecting Family Benefits*, R.S.Q, c. P-19.1, paragraph 241(4)(*j.1*) is amended by repealing subparagraph 241(4)(*j.1*)(*ii*). For further information, please see the commentary on Part XXX, and new section 6500, of the *Income Tax Regulations*.

This amendment comes into force on Royal Assent.

ITA
241(4)(*j.2*)

New paragraph 241(4)(*j.2*) is added concurrently with the repeal of section 122.64, to allow information relevant to the application of section 122.62 to be provided to an official of the government of a province, solely for the purposes of the administration or enforcement of a prescribed law of the province. New section 6500 of the *Income Tax Regulations* prescribes provincial laws for the purposes of paragraph 241(4)(*j.2*).

This amendment comes into force on Royal Assent.

Clause 88

Exclusion – certain guarantees

ITA
247(7.1)

Subsection 247(7) of the Act provides that subsection 247(2) does not apply to adjust the interest on loans (described in subsection 17(8)) that are made by a corporation resident in Canada to a non-resident subsidiary controlled corporation. New subsection 247(7.1) is introduced to provide a parallel exception for fees paid to a Canadian resident corporation for loan guarantees provided by it in respect of a non-resident subsidiary controlled corporation.

Subsection 247(7.1) provides that subsection 247(2) will not apply to adjust the amount of consideration paid, payable or accruing to a corporation resident in Canada (the Parent) in a taxation year of the Parent for the provision of a guarantee of the repayment, in whole or in part, of an amount owing by a non-resident person if the non-resident person is a controlled foreign affiliate of the Parent for the purposes of section 17 throughout the period in the year during which the particular amount is owing and it is established the amount owing would, if it were owed to the Parent, be described in paragraph 17(8)(*a*) or (*b*).

This amendment generally applies to taxation years that begin after 1997, subject to an election regarding its application to statute-barred years. In applying subsection 247(7.1) to taxation years that begin before February 24, 1998, section 17 is to be read as it read on January 24, 2005.

Clause 89

Definitions

Subsection 248(1) of the Act provides a number of definitions that apply for the purposes of the Act.

ITA
248(1)

“automobile”

For the purposes of the Act, an “automobile” is defined as a motor vehicle designed primarily to carry individuals on highways and streets and having a seating capacity of not more than nine people (including the driver). However, various types of motor vehicles are excluded from the definition. Subparagraph (*e*)(iii) of the definition generally provides that an “automobile” does not include a pick-up truck used primarily for the transportation of goods, equipment or passengers in the course of earning or producing income at one or more remote or special worksites that are at least 30 kilometres

from the nearest urban area having a population of at least 40,000 persons. "Urban area" is defined by Statistics Canada in the *Census Dictionary*.

Clause (*e*)(iii)(B) of the definition "automobile" is amended to replace the term "urban area" with "population centre" as a result of the adoption by Statistics Canada of the term "population centre" in place of "urban area".

This amendment applies to the 2013 and subsequent taxation years.

"derivative forward agreement"

The definition "derivative forward agreement" is added to subsection 248(1). A derivative forward agreement essentially combines a derivative financial instrument with the purchase or sale of an otherwise unrelated capital property. Income from derivative investments is generally fully taxable as ordinary income. Derivative forward agreements are typically used in an attempt to convert this fully taxable derivative income to a capital gain, only half of which is included in income. A derivative forward agreement therefore involves the purchase or sale of a capital property.

Paragraph (*a*) of the definition requires that the term of the agreement exceed 180 days or the agreement be part of a series of agreements with a term that exceeds 180 days. For example, a series of seven 30-day "rolling" forward agreements, where a new agreement is entered into as soon as its predecessor concludes, would have a term that exceeds 180 days. In contrast, two agreements that each have a term of 100 days and operate concurrently (i.e., they have the same start and end dates) would not have a term that exceeds 180 days, even if they are part of the same series.

Purchase Agreements

Paragraph (*b*) of the definition deals with agreements to purchase a capital property. In order for a purchase agreement to be a derivative forward agreement, the economic return on the agreement must have a derivative component. The economic return under such a purchase agreement is the difference between the price paid for the property and the fair market value of the property when it is delivered. If the agreement is a derivative forward agreement, this return will be included (or potentially deducted if there is a loss) in computing the taxpayer's income under paragraph 12(1)(*z.7*) (or paragraph 20(1)(*xx*)).

For the purpose of determining whether the return has a derivative component, the return must be attributable, in whole or in part, to an underlying interest that is not described in subparagraph (*b*)(i) or (ii). The term "underlying interest" is intended to have a broad meaning and it includes a value, price, rate, variable, index, event, probability or thing. For example, the return could be based on the value of a reference fund, 1.5 times the return on the TSX over a period of time, LIBOR, an express or implied fixed interest rate or the price of a commodity.

Subparagraphs (*b*)(i) and (ii) of the definition excludes certain underlying interests. Subparagraph (*b*)(i) essentially provides that, where the economic return on the purchase of a property is based on the economic performance of the property being purchased, the purchase agreement will not be a derivative forward agreement. Subparagraph (*b*)(ii) ensures that, where the purchase price of the property is denominated in a foreign currency, changes in the value of the Canadian currency relative to the foreign currency will not cause the purchase agreement to be a derivative forward agreement.

Sale Agreements

Paragraph (*c*) of the definition deals with agreements to sell a capital property. The determination of whether a sale agreement meets the conditions in paragraph (*c*) involves two steps:

(i) Is there a derivative component to the agreement?

(ii) If so, is the taxpayer's economic exposure primarily based on the property being sold?

Subparagraph (*c*)(i) tests whether the taxpayer's economic return has a derivative component. The return on a sale agreement is the difference between the fair market value of the property at the time the agreement is entered into and the sale price of the property. As with purchase agreements, a sale agreement will not be a derivative forward agreement where the economic return under the agreement is attributable to the economic return on the property being sold. Where the sale price of the property is denominated in a foreign currency, changes in the value of the Canadian currency relative to the foreign currency will not cause the sale agreement to be a derivative forward agreement.

Since the economic return under the agreement is based upon the difference between the fair market value of the property at the time the agreement is entered into and the sale price of the property, payments under the agreement that relate to the fair market value of the property at the time the agreement is entered into are not included in determining the economic return. For example, that may be the case where the parties to a transaction agree to defer the determination and payment of the portion of the purchase price that is based on a hard to value asset (e.g., goodwill).

Subparagraph (*c*)(ii) provides that an agreement will not be a derivative forward agreement where the taxpayer retains a substantial level of economic exposure to the property being sold. An agreement will not be a derivative forward agreement unless the agreement is part of an arrangement that has the effect of eliminating a majority of the taxpayer's opportunity for profit and risk of loss in respect of the property for a period of more than 180 days (a deeming rule applies where such agreements are entered into by non-arm's length persons). This ensures that the derivative forward agreement rules will not apply where the taxpayer's economic exposure is still based primarily on the property being sold, even if there is a derivative component to the sale agreement.

For further information on the elimination of risk of loss and opportunity for gain or profit, see the commentary under the definition "synthetic disposition arrangement" in subsection 248(1).

Example – Put/Calls

A taxpayer has a property worth $100. If the taxpayer writes a covered call option that allows the option holder to acquire the property for $105 in a year, the taxpayer would retain an economic exposure to $5 of upside and all of the downside in respect of the property. Where the property is sold on the exercise of the call option, the agreement would not be a derivative forward agreement.

On the other hand, if the taxpayer writes the same covered call option and acquires a put option that allows it to sell the property in a year for $105, the taxpayer would have eliminated their economic exposure to the property (if the value of the property exceeds $105 in a year, the call option holder would be expected to exercise the call option and purchase the property for $105 and if the value of the property is less than $105 in a year, the taxpayer would exercise the put option and sell the property for $105). Where the property is sold on the exercise of either the put option or the call option, the relevant agreement would be a derivative forward agreement.

Example – Exchangeable Shares

A taxpayer owns 100 shares of Yco, a Canadian corporation. The terms of the Yco shares contain a right to redeem the shares (along with a limited right for Yco to retract) at any time in exchange for shares of Zco, a publicly traded foreign corporation, or an amount of cash determined by reference to the value of the Zco shares. The value of the Yco shares therefore tracks the value of the Zco shares.

The taxpayer provides Callco, a Canadian corporation, with a call right that entitles it to purchase the taxpayer's Yco shares for a price determined by reference to the value of a corresponding number of Zco shares. In this situation, the taxpayer would retain a sufficient economic exposure to the Yco shares and the agreement to sell its Yco shares would therefore not be a derivative forward agreement.

Conversely, if the Yco shares do not have an embedded exchange right and instead, the taxpayer enters into an agreement to sell the Yco shares more than 180 days in the future for a price determined by reference to the value of the Zco shares, the agreement would be a derivative forward agreement.

The definition "derivative forward agreement" is used for a number of purposes. An income inclusion is provided in paragraph 12(1)(*z.7*) where a derivative forward agreement results in a profit. A deduction is provided in paragraph 20(1)(*xx*) where a derivative forward agreement results in a loss. An increase in the adjusted cost base of the capital property purchased or sold is provided by paragraphs 53(1)(*s*) and (*t*) where an amount is included in a taxpayer's income under paragraph 12(1)(*z.7*). Similarly, a decrease in the adjusted cost base of the capital property is provided in paragraphs 53(2)(*w*) and (*x*) where an amount is deductible under paragraph 20(1)(*xx*).

For further information, see the commentary on paragraphs 12(1)(*z.7*), 20(1)(*xx*), 53(1)(*s*) and (*t*) and 53(2)(*w*) and (*x*).

Example – Forward Sale

A mutual fund trust purchases a portfolio of non-dividend paying Canadian securities worth $100 million. These are capital properties to the trust. The trust then enters into an agreement to sell the portfolio of Canadian securities to a counterparty in five years for a price determined by reference to the performance of a bond fund (i.e., the price is equivalent to what a $100 million investment in the bond fund would be worth after five years).

At the end of the five-year term of the forward sale agreement, the portfolio of Canadian securities is worth $110 million and the notional investment in the bond fund would be worth $125 million. The portfolio of Canadian securities would therefore be sold for $125 million (irrespective of the fair market value of the Canadian securities portfolio at the end of the five-year term).

The sale agreement would be a derivative forward agreement. It has a term in excess of 180 days. The difference between the fair market value of the property sold at the time of entering into the agreement ($100 million) and the sale price ($125 million) is determined by reference to an underlying interest (i.e., the notional investment in the bond fund) that is unrelated to the property sold. Lastly, the sale agreement has the effect of eliminating a majority of the trust's opportunity for gain or profit and risk of loss in respect of the Canadian securities portfolio.

The mutual fund trust would be required to include $25 million in computing its income for the year of the sale under paragraph 12(1)(z.7), being the difference between the fair market value of the property at the time the agreement is entered into ($100 million) and its sale price ($125 million). The total adjusted cost base of the Canadian securities would be increased by $25 million under paragraph 53(1)(t) so that there would be no capital gain or loss on the disposition of the Canadian securities for $125 million.

Example – Forward Purchase

A mutual fund corporation enters into an agreement to purchase a portfolio of Canadian securities in five years. It prepays its obligation to purchase the portfolio upon entering into the agreement for $100 million. The value of the Canadian securities to be delivered on settlement of the agreement is determined by reference to the performance of a fund that invests primarily in dividend-paying foreign equities (i.e., the value of Canadian securities to be delivered is equivalent to what a $100 million investment in the equity fund would be worth after five years). The securities purchased are capital properties to the mutual fund corporation.

At the end of five years, the notional investment in the equity fund would be worth $125 million. The counterparty to the purchase agreement therefore delivers a portfolio of Canadian securities to the mutual fund corporation with a value of $125 million, which is immediately sold by the mutual fund corporation for cash proceeds of $125 million. The composition of the Canadian securities portfolio is not particularly relevant, provided the purchaser is able to sell the purchased securities immediately for their fair market value (i.e., they are sufficiently liquid).

The purchase agreement would be a derivative forward agreement. It has a term in excess of 180 days. The difference between the value of the property delivered (i.e., the Canadian securities portfolio) and the price paid for the property is unrelated to the economic performance of the property. It is based on the performance of the equity fund (i.e., the underlying interest).

The mutual fund corporation would be required to include $25 million in its income under paragraph 12(1)(z.7), being the difference between the fair market value of the Canadian securities portfolio when the agreement is settled ($125 million) and the price paid for the Canadian securities ($100 million). Its total adjusted cost base of the Canadian securities would be increased by $25 million under paragraph 53(1)(s). It would therefore have no gain or loss on the disposition of the Canadian securities for $125 million.

The definition "derivative forward agreement" comes into force on March 21, 2013.

"estate"

The definition "estate" assigns to that term for the purposes of the Act the meaning it has under subsection 104(1). Subsection 104(1) provides that a reference to an estate is to be read as including, among other things, the executor or liquidator of a succession having ownership or control of the estate property. The English version of the definition is amended to clarify that a reference to estate includes, for civil law, a succession. The term "*succession*" used in French version of the Act describes both the common-law and civil law institutions without requirement for further amendment. This amendment comes into force on Royal Assent.

"LIA policy"

The new definition "LIA policy" describes a leveraged insured annuity arrangement entered into after March 20, 2013. In particular, an LIA policy is one in respect of which funds, borrowed after March 20, 2013, are used in connection with a lifetime annuity and a life insurance policy. An LIA policy does not include a policy in respect of which the amount of borrowings outstanding as of March 21, 2013 does not increase on or after that date. The policy and the annuity are both issued on the life of an individual and the annuity provides that payments are to continue for a period that ends no earlier than the death of the individual. The lender is assigned an interest in the policy and in the annuity

contract and the borrowed amount is repayable at a time that is determined based on the death of the individual.

A series of related amendments that apply to LIA policies are intended to eliminate a number of income tax benefits previously available in respect of leveraged insured annuities. For further information, see the commentary on paragraph 20(1)(*e.2*), subsection 70(5.31) and the definition "capital dividend account" in subsection 89(1) of the Act, and subsections 201(5.1) and 306(1) of the *Income Tax Regulations*.

This amendment applies to taxation years that end after March 20, 2013.

"majority-interest partner"

The term "majority interest partner" is amended to refer instead to a "majority-interest partner". A number of related amendments are made to provisions in the Act that refer to the term and that do not currently use a hyphen in the reference. This amendment comes into force on Royal Assent.

"synthetic disposition arrangement"

A synthetic disposition arrangement in respect of a property owned by a taxpayer is generally any agreement, series of agreements or other arrangement that allows a taxpayer to eliminate all or substantially all of both the taxpayer's risk of loss and opportunity for gain or profit in respect of the property for a definite or indefinite period of time. A synthetic disposition arrangement would not include an arrangement that eliminates only the taxpayer's risk of loss or only the taxpayer's opportunity for gain or profit.

A taxpayer's opportunity for gain or profit in respect of a property would include the taxpayer's rights (whether contingent or absolute) to earn income (e.g., dividends) or to obtain other benefits in respect of the property and the taxpayer's right to economically participate in any increase in the value of the property. Likewise, a taxpayer's risk of loss would include any liabilities (whether contingent or absolute) or obligations to provide benefits in respect of the property and the taxpayer's economic exposure to any decreases in the value of the property.

A taxpayer will not be considered to retain opportunity for gain or profit in respect of a property if the arrangement provides for an offsetting liability (e.g., where a taxpayer has a right to receive dividends on shares it owns, but has a corresponding obligation to pay the amount of any dividends it receives to a third party). Similarly, a taxpayer will not be considered to retain risk of loss where the arrangement provides for an offsetting benefit.

The determination of whether all or substantially all of a taxpayer's risk of loss and opportunity for gain or profit in respect of a property has been eliminated is highly factual. Depending on the circumstances, a taxpayer might be considered to have eliminated their risk of loss even if, for example, any or all of the following are retained:

- risk that a dividend or other return may not be paid or provided in relation to the property;
- risk as to a worsening of the creditworthiness of any party to the arrangement;
- risk as to changes in interest rates; or
- risk as to fluctuations in foreign currency exchange rates.

Similarly, depending on the circumstances, a taxpayer might be considered to have eliminated their opportunity for gain or profit even if, for example, any or all of the following are retained:

- opportunity to benefit from a dividend or other return being paid or provided in relation to the property;
- opportunity to benefit from an improvement in the creditworthiness of any party to the arrangement;
- opportunity to benefit from changes in interest rates; or
- opportunity to benefit from fluctuations in foreign currency exchange rates.

Although the definition "synthetic disposition arrangement" applies in respect of a property, there is no requirement that the agreement or arrangement or series of agreements be legally related to the property. For example, a synthetic disposition arrangement in respect of a property of a taxpayer could involve a cash settled derivative that offsets the taxpayer's economic interest in the property but that does not require that the taxpayer own the underlying property.

The synthetic disposition rules are based on the effects of an arrangement. Since different components of a synthetic disposition arrangement can be entered into by different parties, the definition contains a deeming rule that applies to arrangements that are entered into by non-arm's length persons or partnerships. For the purpose of determining whether an arrangement has the effect of eliminating a taxpayer's risk of loss and opportunity for gain or profit, arrangements entered into by non-arm's length persons and partnerships are deemed to have been entered into by the taxpayer. Where an arrangement is entered into by a person or partnership that does not deal at arm's length with the taxpayer, it must be reasonable to conclude that the arrangement was entered into, in whole or in part, with the purpose of achieving this effect. This ensures that the synthetic disposition rules will not apply to a taxpayer when a non-arm's length person inadvertently enters into a transaction that economically offsets a transaction entered into by the taxpayer.

Below are a number of simplified examples that illustrate the general types of considerations that are relevant in determining whether or not there is a synthetic disposition arrangement. Application of the synthetic disposition rules in a particular situation will depend largely on its facts.

Examples – Put-Call Arrangement

Example 1 (synthetic disposition arrangement) – A taxpayer owns a non-income producing property with a value of $85. The taxpayer acquires a right to sell the property for $100 in five years (a put) and grants a right to buy the property for $100 in five years (a call). The taxpayer has eliminated all or substantially all of both the taxpayer's risk of loss and opportunity for gain or profit in respect of the property. At the end of five years, if the property is worth $115, the call option holder will exercise the right and purchase the property for $100. If, instead, the property is worth $85 at the end of five years, the taxpayer would exercise the put right and sell the property for $100.

Example 2 (synthetic disposition arrangement) – A taxpayer owns shares of a publicly traded company with a value of $100 and the company is not expected to pay dividends in the foreseeable future. The taxpayer buys (for $4) a right to sell the property for $100 in two years and sells (for $4) a right to buy the property for $102 in two years. The taxpayer would have entered into a synthetic disposition arrangement because the taxpayer has eliminated substantially all their risk of loss and opportunity for gain or profit in respect of the property. The taxpayer would also be considered to have entered into a synthetic disposition arrangement if the taxpayer sold (for $99) a right to buy the property for $2 in two years, as it would be reasonable to expect the option holder to exercise the option.

Example 3 (not a synthetic disposition arrangement) – A taxpayer owns a property with a value of $100. The taxpayer buys (for $1) a right to sell the property for $50 in five years and sells (for $1) a right to buy the property for $150 in five years. In this example, the taxpayer would retain a significant economic exposure to the property and would generally not be considered to have eliminated all or substantially all of either of the taxpayer's risk of loss or opportunity for gain or profit.

Examples – Secured Loan

Example 1 (synthetic disposition arrangement) – A taxpayer owns a property with a value of $100. As part of an arrangement, the taxpayer receives a loan of $100 and receives a right to settle the loan by transferring the property to the lender. Also as part of the arrangement, the lender obtains the right to acquire the property for $100. The taxpayer has eliminated substantially all of both the taxpayer's risk of loss and opportunity for gain or profit in respect of the property. If the property's value exceeds $100 at the end of the term of the loan, the lender would exercise its right to acquire the property for $100. If the property's value is less than $100 at the end of the term of the loan, the taxpayer would use the property to settle the loan.

Example 2 (not a synthetic disposition arrangement) – A taxpayer owns a property with a value of $100. A taxpayer receives a loan of $100 that is secured by the property. The taxpayer would generally not be considered to have eliminated substantially all of either of the taxpayer's risk of loss or opportunity for gain or profit. Even if the taxpayer received a right to settle the debt with the property, the taxpayer would not generally be considered to have entered into a synthetic disposition arrangement since the taxpayer would not have eliminated all or substantially all of the taxpayer's opportunity for gain or profit in respect of the property.

Examples – Future Sale

Example 1 (synthetic disposition arrangement) – A taxpayer enters into an agreement to sell a non-income producing property with a current fair market value of $100 in five years for $120. Upon entering into the agreement, the taxpayer is obligated to sell the property at the future date for the specified price. The taxpayer has eliminated all or substantially all of both the taxpayer's risk of loss and opportunity for gain or profit in respect of the property because the taxpayer's return is determined without regard to the economic performance of the property.

Example 2 (synthetic disposition arrangement) – A taxpayer enters into an agreement to sell 100 shares of ABC Co. with a current fair market value of $100 in five years for $120. The $120 sale price will be decreased based upon dividends paid on the ABC Co. shares. Alternatively, the taxpayer is required to pass on the dividends it receives to the purchaser. As with Example 1, the taxpayer has eliminated all or substantially all of both the taxpayer's risk of loss and opportunity for gain or profit in respect of the property because the taxpayer's return is determined without regard to the economic performance of the property.

Example 3 (not a synthetic disposition arrangement) – A taxpayer enters into an agreement to sell a property at a future date at a price determined by the value of the property at that future date. The taxpayer would not be considered to have eliminated substantially all of either their risk of loss or opportunity for gain or profit.

Example 4 (not a synthetic disposition arrangement) – A taxpayer enters into an agreement to sell 100 shares of ABC Co. to a purchaser for $100, but only if the purchaser obtains regulatory approval for the sale. When the agreement was entered into, there was a real risk that regulatory approval would not be obtained. The taxpayer has not eliminated all or substantially all of the taxpayer's risk of loss and opportunity for gain or profit in respect of the shares while this bona fide condition precedent remains outstanding.

Examples – Short Sale

Example 1 (synthetic disposition arrangement) – A taxpayer borrows 100 ABC Co. shares and immediately sells the shares for their fair market value. The taxpayer then buys 100 ABC Co. shares. The taxpayer would have entered into a synthetic disposition arrangement in respect of the 100 ABC Co. shares that were purchased because the arrangement has eliminated substantially all of both the taxpayer's risk of loss and opportunity for gain or profit in respect of the property.

Example 2 (not a synthetic disposition arrangement) – A subsidiary of a large corporation makes a portfolio investment in 100 ABC Co. shares because its investment manager has a bullish outlook on ABC Co. Another subsidiary sells 100 ABC Co. shares short because its investment manager has a bearish outlook on ABC Co. The short investment position is taken without knowledge of the long investment. While, taken together, the long and short positions economically offset each other, it cannot be said that the short position was entered into for the purpose of eliminating all or substantially all of the risk of loss and opportunity for gain or profit of the long position.

Examples – Swap

Example 1 (synthetic disposition arrangement) – A taxpayer owns ABC Co. shares with a cost of $10 and a fair market value of $100. The taxpayer enters into a five-year total return swap with a counterparty under which the taxpayer will pay the counterparty the amount of any dividends plus any increases in value in the ABC Co. shares at the end of five years. In return, the taxpayer receives swap payments based on LIBOR as well as an amount equal to any decrease in the value of the ABC Co. shares at the end of five years. This is a synthetic disposition arrangement because the taxpayer has eliminated substantially all of both the taxpayer's risk of loss and opportunity for gain or profit in respect of the property over the five-year term of the total return swap even if the taxpayer retains ownership of the property at the end of the term of the agreement.

Example 2 (not a synthetic disposition arrangement) – A taxpayer owns ABC Co. shares with a cost of $10 and a fair market value of $100. The taxpayer enters into a five-year swap with a counterparty under which the taxpayer will pay the counterparty the amount of any dividends received on the ABC Co. shares (but no amount based on any increase in the value of the ABC Co. shares). In return, the taxpayer receives swap payments based on the dividends received on XYZ Co. shares (but no amount based on any decrease in the value of the ABC Co. shares). The price of the ABC Co. shares is volatile and most of the taxpayer's opportunity for gain or profit (and risk of loss) in respect of the shares is based on the potential appreciation (or depreciation) in the value of the ABC Co. shares. Since the taxpayer retains a significant economic exposure to the ABC Co. shares, the arrangement would not be a synthetic disposition arrangement.

The definition “synthetic disposition arrangement” comes into force on March 21, 2013.

“synthetic disposition period”

The “synthetic disposition period” of a synthetic disposition arrangement is the definite or indefinite period of time during which the one or more agreements or other arrangements have the effect, or would have the effect if entered into by the taxpayer, of eliminating all or substantially all the taxpayer’s risk of loss and opportunity for gain or profit in respect of a property. The term “synthetic disposition arrangement” is also defined in subsection 248(1).

The definition “synthetic disposition period” comes into force on March 21, 2013.

“trust”

The definition “trust” assigns to that term for the purposes of the Act the meaning it has under subsection 104(1). The definition is amended to clarify that a reference to a trust in the Act includes, unless the context otherwise requires, an estate. This amendment comes into force on Royal Assent.

“10/8 policy”

The new definition “10/8 policy” generally describes a life insurance policy in respect of certain arrangements under which a taxpayer invests amounts in the policy that are then, in effect, returned to the taxpayer under a collateral loan arrangement (i.e., where the lender has been assigned an interest in the policy or in an investment account in respect of the policy that becomes available in connection with the borrowing) or a policy loan arrangement (i.e., under which amounts are advanced to the policyholder under the terms of the insurance contract, as described in the definition “policy loan” in subsection 148(9), and in connection with which an investment account in respect of the policy becomes available). For the policy to be a 10/8 policy, an additional condition must be met; either:

- The return credited to an investment account in respect of the policy is determined by reference to the rate of interest on the borrowing or the policy loan and would not be so credited if the borrowing or policy loan were not in existence; or
- The maximum amount of an investment account in respect of the policy is determined by reference to the amount of the borrowing or the policy loan.

A series of related amendments apply to 10/8 policies and are intended to eliminate the income tax benefits previously available in respect of these arrangements. In addition, a transitional rule is provided to facilitate the termination of existing arrangements. For more information, see the commentary on paragraph 20(1)(*e.2*), subsection 20(2.01), the definition “capital dividend account” in subsection 89(1), and subsection 148(5).

This amendment applies to taxation years that end after March 20, 2013.

Clause 90

Year-end on certain events

ITA
249(4)

Subsection 249(4) of the Act provides that if a control of a corporation is acquired at any time, the corporation is deemed to have a year-end immediately before that time, and to start a new taxation year at that time. However, if control of the corporation is acquired within seven days of the corporation’s preceding taxation year having ended, the corporation can (unless there is an intervening

acquisition of control of the corporation during those seven days) elect to extend that preceding taxation year to include those additional days.

Subsection 249(4) is amended to extend its application to trusts. Specifically, the subsection applies to a taxpayer that is a corporation or trust and that is subject to a loss restriction event. The rules in existing paragraphs 249(4)(*a*), (*b*) and (*d*) are included in new paragraph 249(4)(*a*), providing a structure consistent with that found in paragraph 149(10)(*a*). Consequential on this change, existing paragraph 249(4)(*c*) is renumbered as paragraph 249(4)(*b*).

For further information on loss restriction events, see the commentary on section 251.2.

This amendment comes into force on March 21, 2013.

Clause 91

Affiliated persons

ITA
251.1

Section 251.1 of the Act sets out rules for determining when persons (including partnerships) are affiliated with one another, which is relevant to a number of provisions of the Act, most notably those restricting the realization of losses on certain transfers.

ITA
251.1(1), (3) and (4)

Paragraph 251.1(1)(*e*) of the Act provides that a partnership and a majority interest partner of the partnership are affiliated with each other. The reference in the English version of the paragraph to “majority interest partner” is changed to “majority-interest partner” consequential on a similar change to the definition “majority-interest partner” in subsection 248(1).

Paragraph (*a*) of the definition “majority-interest group of partners” in subsection 251.1(3) defines a majority-interest group of partners of a partnership to mean a group of persons each of whom has an interest in the partnership such that if one person held all of those interests that person would be a majority interest partner of the partnership. The reference in the English version of the paragraph to “majority interest partner” is changed to “majority-interest partner” consequential on a similar change to the definition “majority-interest partner” in subsection 248(1).

Subparagraph 251.1(4)(*d*)(iv) provides that for purposes of section 251.1 in determining whether a person is affiliated with a trust, in determining whether a contributor to one trust is affiliated with a contributor to another trust, individuals connected by blood, marriage common-law partnership or adoption are deemed to be affiliated with one another. The English version of the subparagraph is amended to replace the reference to connection by blood with a reference to connection by blood relationship. This clarifies that the relationships described in the subparagraph are intended to be connected as described in subsection 251(6), which refers to blood relationship.

These amendments come into force on Royal Assent.

Clause 92

Loss restriction event

ITA
251.2

New section 251.2 of the Act contains rules for determining when a taxpayer is subject to a loss restriction event. A taxpayer's ability to carry over for income tax purposes certain undeducted amounts is constrained if the taxpayer is subject to a loss restriction event.

New section 251.2 comes into force on March 21, 2013.

Definitions

ITA
251.2(1)

Subsection 251.2(1) of the Act contains definitions that apply for purposes of section 251.2.

"beneficiary"

Beneficiary under a trust has the same meaning as in subsection 251.1(3), which extends its ordinary meaning to include a person beneficially interested in the trust.

"equity"

Equity of a corporation, trust or partnership has the same meaning as in subsection 122.1(1) determined without reference to paragraph (*e*) of the definition in that subsection. Equity means shares of the capital stock of a corporation, a capital interest or income interest in a trust, an interest as a member of a partnership and certain participating debt issued by the relevant entity.

"equity value"

Equity value of a corporation, trust or partnership has the same meaning as in subsection 122.1(1). Equity value is, in effect, the fair market value of all of the relevant entity's equity (ignoring participating debt).

"majority-interest beneficiary"

Majority-interest beneficiary has the same meaning as in subsection 251.1(3).

"majority-interest group of beneficiaries"

Majority-interest group of beneficiaries has the same meaning as in subsection 251.1(3).

"majority-interest group of partners"

Majority-interest group of partners has the same meaning as in subsection 251.1(3).

"person"

A person includes a partnership.

"specified right"

A person's specified right in respect of a trust is similar to the rights in respect of a corporation described in subparagraphs 251(5)(*b*)(i) and (ii) of the Act. A specified right in respect of a trust is a right to acquire, or to cause a trust to redeem or cancel, equity of the trust. Specified rights may be

held under a contract, in equity or otherwise and may be immediate or future, absolute or contingent. Specified rights are subject to an anti-avoidance rule in subparagraph 251.2(5)(*b*)(iii). For more information, see the commentary on that subparagraph.

"subsidiary"

A subsidiary of a particular person (including a partnership) means a corporation, partnership or trust (the subject entity) in which the particular person holds directly or indirectly a majority interest (i.e., property representing more than 50% of the fair market value of the subject entity's equity value). Under paragraph (*a*) of the definition, the determination of whether a subject entity is the subsidiary of a particular person is made having regard to both property held by the particular person that is equity (including participating debt) of the subject entity and property held by the particular person that derives its value from equity of the subject entity. For example, in making the determination of whether a subject entity corporation is a subsidiary of a particular person, regard would be had to shares of the capital stock of the subject entity held by the particular person, as well as a capital interest in a trust that is held by the particular person if the trust in turn holds, directly or indirectly, equity of the subject entity.

Paragraph (*b*) of the definition applies to determine whether the property held by a particular person and described in paragraph (*a*) of the definition constitutes, in effect, a majority interest in the subject entity. The equity value of the subject entity is used for this purpose. Equity value is the fair market value of all of the subject entity's equity (ignoring participating debt) at the relevant time. If the total fair market value of a particular person's property described in paragraph (*a*) in respect of a subject entity (but in the case of property described in subparagraph (*a*)(ii), only the applicable portion of that fair market value) is more than 50% of the subject entity's equity value, the subject entity is treated as that person's subsidiary.

The subsidiary concept is used in paragraphs 251.2(3)(*c*) and (4)(*a*) in determining whether a trust is subject to a loss restriction event at any time. For more information, see the commentary on those paragraphs.

Loss restriction event

ITA
251.2(2)

Subsection 251.2(2) of the Act describes the circumstances in which a corporation or trust is subject to a loss restriction event. A corporation is subject to a loss restriction event when control of the corporation is acquired by a person or group of persons. For this purpose, subsection 256(7) applies. For further information, see the commentary on that subsection.

A trust is subject to a loss restriction event at any time after creation of the trust and March 20, 2013 if at that time a person becomes majority-interest beneficiary, or a group of persons becomes a majority-interest group of beneficiaries, of the trust. For this purpose, subsection 251.2(4) deems certain transactions and events to cause a person to become a majority-interest beneficiary of a trust. Subsection 251.2(4) is, however, subject to subsection 251.2(3), which describes certain transactions and events that on their own are deemed not to cause a person to become a majority-interest beneficiary, or a group of persons to become a majority-interest group of beneficiaries, under a trust. A number of anti-avoidance rules in subsection 251.2(5) also apply in determining whether at any time a person becomes a majority-interest beneficiary, or a group of persons becomes a majority-interest

group of beneficiaries, of a trust. For further information, see the commentary on subsections 251.2(3), (4) and (5).

Trust – exceptions

ITA
251.2(3)

Subsection 251.2(3) of Act describes certain transactions and events in respect of which, for the purpose of determining whether a particular trust is subject to a loss restriction event, a person or group of persons is deemed not to become a majority-interest beneficiary or majority-interest group of beneficiaries, respectively, of the particular trust. In general terms, subsection 251.2(3) describes transfers or acquisitions of trust equity within affiliated groups of persons.

Paragraph 251.2(3)(*a*) deems a person not to become a majority-interest beneficiary, and a group of persons not to become a majority-interest group of beneficiaries, as the case may be, of a particular trust solely because of the acquisition of equity (generally, a capital interest or income interest) of the particular trust by

- a particular person from a person with whom they are affiliated
- a particular person who is affiliated with the trust;
- the estate of a deceased individual from the individual as a matter of the individual's succession; and
- a particular person from an estate if the estate acquired the equity from an individual as described in the immediately preceding bullet, and the particular person was affiliated with the individual immediately before the individual's death.

Paragraph 251.2(3)(*b*) deems a person not to become a majority-interest beneficiary, and a group of persons not to become a majority-interest group of beneficiaries, as the case may be, of a trust solely because of certain transactions or events. These include a variation of the terms of the trust, as well as certain transactions effected under the terms of the trust or by decision of the trustees. The paragraph applies provided that immediately after the relevant transaction or event the only persons that are majority-interest beneficiaries, or members of a group of majority-interest beneficiaries, in the trust are persons that were affiliated with the trust immediately before that time (or, where the transaction involves the extinguishment of a beneficial interest in the trust held by a deceased individual's estate and acquired by the estate from the individual as a matter of the individual's succession, those persons are affiliated with the trust immediately before the individual's death).

Paragraph 251.2(3)(*c*) provides that a person is deemed not to become a majority-interest beneficiary, and a group of persons is deemed not to become a majority-interest group of beneficiaries, as the case may be, of a particular trust solely because the equity holders (i.e., beneficiaries, and holders of participating debt, of the particular trust) transfer all of that equity to a corporation, partnership or another trust (the acquirer). The paragraph applies only if a number of other conditions are met. Firstly, the only consideration for the transfer can be shares, partnership memberships or trust beneficial interests, as the case may be, of the acquirer. Second, the acquirer must be, in effect, a new entity, not having held property before the transfer, or having held before the transfer only property of nominal value. Third, immediately after the transfer the acquirer cannot be a subsidiary (as defined in subsection 251.2(1)) of another person and, if the acquirer is a corporation, cannot be under the legal or factual control of another person. (Note that even if this third additional condition is met, the trust

may be subject to a loss restriction event by operation of paragraph 251.2(4)(*a*) if the acquirer subsequently becomes the subsidiary of another person).

Paragraph 251.2(3)(*c*), in effect, applies in respect of certain internal reorganizations involving the interests of all the beneficiaries under a trust.

Paragraph 251.2(3)(*d*) provides that a person is deemed not to become a majority-interest beneficiary, and a group of persons is deemed not to become a majority-interest group of beneficiaries, as the case may be, of a particular trust solely because a transfer of equity of the particular trust to a corporation, partnership or another trust (the acquirer). The paragraph applies provided that a number of additional conditions are met. The particular trust must have had a majority-interest beneficiary, or a group of persons as a majority-interest group of beneficiaries, immediately before the transfer. In addition, that beneficiary or group of beneficiaries must be immediately after the transfer affiliated with the acquirer as a result of being a beneficiary or member of the acquirer or, in the case of a corporate acquirer, having legal or factual control of the acquirer, and not cease to be so affiliated with the acquirer as part of a series of transactions or events that includes the transfer.

Paragraph 251.2(3)(*d*), in effect, applies in respect of certain reorganizations involving the interests of beneficiaries under a trust provided that the affected interests remain within, and there is no change in, the beneficiary or group of beneficiaries affiliated with the trust.

Paragraph 251.2(3)(*e*) provides relief in respect of certain transactions the parties to which were obligated to complete under a written agreement entered into by the parties before March 21, 2013. These transactions are ignored in determining whether a person or partnership becomes after March 20, 2013 a majority-interest beneficiary, or a group of persons becomes a majority-interest group of beneficiaries, of a trust. The paragraph does not prevent a trust from being subject to a loss restriction event as a result of other transactions (including those involving the same parties), but that are not completed pursuant to the agreement.

Trusts – additional cases

ITA
251.2(4)

Subsection 251.2(4) of the Act describes certain transactions and events in respect of which, subject to the unusual circumstance in which subsection 251.2(3) would also apply to the same transaction or event, a trust is deemed to be subject to a loss restriction event (i.e., by deeming a notional person to have become at the relevant time a majority-interest beneficiary of the trust).

Paragraph 251.2(4)(*a*) applies where a corporation, partnership or trust (the subject entity) is a majority-interest beneficiary, or a member of a group of majority-interest beneficiaries, of a trust. If the subject entity becomes at any time a subsidiary of another person (the acquirer), the paragraph deems, subject to the exceptions in subparagraphs 251.2(4)(*a*)(i) and (ii), a notional person to become a majority-interest beneficiary of the particular trust, resulting in the trust being subject to a loss restriction event. The exception in subparagraph 251.2(4)(*a*)(i) applies to the trust if the acquirer and the trust are affiliated immediately before that time. The exception in subparagraph 251.2(4)(*a*)(ii) applies if, as part of a series of transactions that includes the subject entity becoming the acquirer's subsidiary at that time, paragraph 251.2(4)(*a*) has already applied to deem a person to become a majority-interest beneficiary of the trust. Paragraph 251.2(4)(*a*) ensures that a majority-interest beneficiary, or majority-interest group of beneficiaries, of a trust cannot be used as a "blocker"

between the trust and its owners (determined without reference to the beneficiary or group) to avoid the trust being subject to a loss restriction event where those owners change.

Paragraph 251.2(4)(*b*) provides a "reverse takeover" rule, similar to those found in paragraphs 256(7)(*c*) and (*c.1*) in respect of the acquisition of control of a corporation, that applies if as part of a series of transactions or events two or more persons acquire at a particular time equity of a particular trust (for example, a trust with unused tax attributes available for carry over) in exchange for or upon a redemption or surrender of equity of, or as a consequence of a distribution from, a corporation, partnership or another trust (the target). In these circumstances the paragraph deems, subject to the exceptions in subparagraphs 251.2(4)(*b*)(i) to (iii), a notional person to become a majority-interest beneficiary of the particular trust, resulting in the trust being subject to a loss restriction event.

The exception in subparagraph 251.2(4)(*b*)(i) applies to the particular trust if the target, or a person affiliated with the target, was immediately before the particular time affiliated with the particular trust. Subparagraph 251.2(4)(*b*)(ii) applies to the particular trust if, were a hypothetical person to have acquired all the equity of the particular trust that was actually acquired at or before the particular time and as part of the series, that hypothetical person would not be a majority-interest beneficiary of the trust. Subparagraph 251.2(4)(*b*)(iii) applies to the particular trust if as part of the series paragraph 251.2(4)(*b*) has already applied to deem a person to become a majority-interest beneficiary of the trust.

Trusts – special rules of application

ITA
251.2(5)

Subsection 251.2(5) of the Act contains rules of application for the purpose of determining whether a trust is subject to a loss restriction event at any time. Paragraph 251.2(5)(*a*) contains rules that apply in determining whether persons are affiliated with each other:

- except for the purposes of the definition "subsidiary" in subsection 251.2(1), legal, and not factual, control of a corporation is to be used;
- natural persons are affiliated with each other if they are connected (including within the meaning of subsection 251(6)) by blood relationship, adoption, marriage or common-law partnership; and
- certain conditions in subsections 251.2(3) and (4) requiring that persons be affiliated are deemed not be met if a person acquires equity and it can reasonably be concluded that one of the reasons for the acquisition or any agreement in respect of the acquisition was to cause the relevant condition to be met.

Paragraph 251.2(5)(*b*) contains a series of anti-avoidance rules that apply in respect of certain transactions or events undertaken for reasons that include avoiding a trust being subject to a loss restriction event or the consequences under the Act of a trust being subject to a loss restriction event. Specifically, the paragraph applies in determining whether a particular person becomes at any time a majority-interest beneficiary, or a particular group of persons becomes a majority-interest group of beneficiaries, of a trust. For this purpose, the fair market value of each person's capital interest and income interest in the trust is to be determined at and immediately before that time:

- without reference to the portion of that fair market value that is attributable to property acquired, or to a change in the fair market value of all or part of any capital interest or income interest in the trust, if it can reasonably be concluded that one of the reasons for the acquisition

or change is to cause paragraph 251.2(2)(*b*), or any provision that applies by reference to a trust being subject to a loss restriction event at any time, not to apply; and

- as if each specified right held immediately before that time by the particular person, or by a member of the particular group, in respect of the trust is at that time exercised, if it can reasonably be concluded that one of the reasons for the acquisition of the right is to cause paragraph 251.2(2)(*b*), or any provision that applies by reference to a trust being subject to a loss restriction event at any time, not to apply.

Trusts – time of day

ITA
251.2(6)

Subsection 251.2(6) of the Act deems the time at which a trust is subject to a loss restriction event on a given day to be the beginning of that day (and not any other time on that day at which the event actually occurred). A trust can elect that the deeming rule not apply to it by filing an election with its return of income for its taxation year that ends immediately before the trust is subject to the loss restriction event. A related amendment to section 600 of the *Income Tax Regulations* adds this election to the list of elections for which permission may be sought from the Minister of National Revenue to amend, revoke or extend the time to file an election. For further information, see the commentary on section 600 of the *Income Tax Regulations*.

Clause 93

Acquiring control

ITA
256

Section 256 of the Act provides rules for determining whether corporations are to be considered to be associated and whether control of a corporation has been acquired for the purposes of the Act.

ITA
256(7)

Subsection 256(7) of the Act provides rules for determining whether control of a corporation is deemed to be, or not to be, acquired for the purposes of the Act.

The subsection's preamble, which lists the provisions to which the rules in the subsection apply, is amended to replace the references to certain provisions with a reference to paragraph 251.2(2)(*a*). The replaced references are to: paragraph 80.04(*h*), subsections 10(10), 13(21.2) and (24), 14(12), 18(15), 40(3.4), 66(11.4) and (11.5) and 249(4), sections 18.1, 37, 80, 111 (except subsection 111(11.4)) and 127 and the definition "superficial loss" in section 54. This change is consequential on amendments to the affected provisions to replace references in those provisions to the acquisition of control of a corporation with references to a taxpayer being subject to a loss restriction event. Paragraph 251.2(2)(*a*) sets out the circumstances in which a corporation is subject to a loss restriction event at any time – namely, if at that time control of the corporation is acquired by a person or group of persons. This amendment to the preamble to subsection 256(7) ensures that the affected provisions continue to apply as before, with the determination of whether control of a corporation is acquired at any time for purposes of the affected provisions made by reference to subsection 256(7) *via* paragraph 251.2(2)(*a*) (i.e., because of the reference to that paragraph in the preamble to subsection 256(7)). For further information, see the commentary on the affected provisions and on section 251.2.

This amendment comes into force on March 21, 2013.

ITA
256(7)(*a*)

Paragraph 256(7)(*a*) of the Act describes circumstances in which control of a corporation (or a corporation controlled by the corporation) is considered not to have been acquired for the purposes of certain provisions of the Act. Clause 256(7)(*a*)(i)(D) provides that control of a corporation is deemed not to be acquired solely because of the acquisition at any time of shares of any corporation by a particular person from an estate that arose on the death of another person to whom the particular person was related. This clause is amended to ensure that relief under the clause is available only in respect of shares acquired by a particular person from an estate of a deceased individual if the shares were acquired by the estate as a consequence of the death of that individual and the individual and the particular person were related immediately before the individual's death. The amendment is consistent with new subparagraph 251.2(3)(*a*)(iv), which applies in determining whether a trust is subject to a loss restriction event. For further information, see the commentary on section 251.2.

This amendment comes into force on September 13, 2013.

ITA
256(7)(*h*) and (*i*)

New paragraph 256(7)(*h*) of the Act applies in circumstances in which a trust is subject to a loss restriction event at a particular time after September 12, 2013 and immediately before the particular time the trust, or a group of persons of which the trust is a member, controls a particular corporation. In this case, control of the particular corporation and of each corporation controlled by it is deemed to have been acquired at that time by a person or group of persons. This rule ensures that a trust not be used as a "blocker" between a corporation and its owners (determined without reference to the trust) to avoid an acquisition of control of the corporation when those owners change.

New paragraph 256(7)(*i*) applies in circumstances in which a trust, at a particular time after September 12, 2013, controls a particular corporation and the trustee or other legal representative (the trustee) having ownership or control of the trust property (i.e., including shares of the capital stock of the particular corporation held by the trust) changes. Such a change may arise, for example, because of the death, resignation or substitution of a person acting as trustee.

Paragraph 256(7)(*i*) deems control of the particular corporation not to be acquired solely because of the change, provided that two additional conditions are met. The first additional condition requires that the change in trustees not be part of a series of transactions or events under which beneficial ownership of the trust property changes. The second additional condition requires that no amount of the income or capital of the trust to be distributed at or after the change in trustees be subject to a discretionary power.

These amendments come into force on March 21, 2013.

Deemed exercise of right

ITA
256(8)

Subsection 256(8) of the Act extends the circumstances in which an acquisition of control is considered to have occurred for the purposes of a number of provisions of the Act. If a taxpayer acquires a right referred to in paragraph 251(5)(*b*) with respect to shares, and it can reasonably be

concluded that one of the main purposes of the acquisition of the right is to avoid the application of certain income tax provisions that are triggered on an acquisition of control, subsection 256(8) applies to treat the right as having been exercised.

Consequential on the introduction of the new corporate loss trading rules in section 256.1, subsection 256(8) is amended to add a reference to subsections 88(1.1) and (1.2). Subsection 88(1.1) allows a parent corporation under certain circumstances to use non-capital losses of a subsidiary corporation that has been wound up. Subsection 88(1.2) provides a similar rule with respect to net capital losses. Under both subsections, however, limits may apply where there is an acquisition of control of the parent or subsidiary, including where section 256.1 deems there to have been an acquisition of control of the parent or subsidiary.

This amendment comes into force on March 21, 2013.

Paragraph 256(8)(*b*) is amended to add subsection 251.2(2) to the list of provisions that are triggered by an acquisition of control and the intended avoidance of which can trigger the application of subsection 256(8). Subsection 251.2(2) provides that a corporation is subject to a loss restriction event when control of it is acquired by a person or group of persons. For further information, see the commentary on section 251.2.

If subsection 256(8) applies, it treats the taxpayer as having exercised the right in question for a number of provisions for the purpose of determining whether control of the relevant corporation is acquired or whether the corporation is controlled by any person or group of persons. The list of provisions is amended by adding a reference to paragraph 251.2(2)(*a*), which provides that a corporation is subject to a loss restriction event when control of it is acquired by a person or group of persons. The list of provisions is also amended to add references to paragraphs 251.2(3)(*c*) and (*d*), which apply, in part, by reference to whether a corporation is controlled by a person or group of persons.

These amendments come into force on March 21, 2013.

Clause 94

Corporate tax-attribute trading

ITA
256.1

The Act contains a number of provisions meant to constrain the trading of corporate tax attributes among arm’s length persons. Nevertheless, transactions intended to circumvent these provisions continue to be undertaken. Depending on the particular facts, these transactions are challenged by the Canada Revenue Agency based on existing rules in the Act. However, as any such challenge could be time-consuming and costly, the Government announced in Economic Action Plan 2013 that it is introducing new section 256.1 to ensure that the appropriate tax consequences apply to these transactions.

Definitions

ITA
256.1(1)

New subsection 256.1(1) of the Act provides definitions that apply for the purposes of section 256.1.

“attribute trading restriction”

An “attribute trading restriction” is defined to be a restriction on the use of a tax attribute arising on the application, either alone or in combination with other provisions, of various sections and subsections of the Act. Depending on the type of tax attribute, the restrictions deny or limit the deduction of, among other tax attributes, a corporation’s loss carryover pools, investment tax credit carryover pools, resource expense pools and scientific research and experimental development expenditure pools. The definition “attribute trading restriction” is relevant for the purpose of applying the anti-avoidance rules in subsections 256.1(3) and (6), which deem an acquisition of control of a corporation to have occurred in certain circumstances. For further information, see the commentary on subsections 256.1(3) and (6).

“person”

The definition “person” includes a partnership.

“specified provision”

A “specified provision” is defined to be any of various provisions in the Act that generally restrict the deductible amount of a corporate tax attribute on an acquisition of control of the corporation. These restrictions apply, among other tax attributes, to limit the deductibility of a corporation’s loss carryover pools, investment tax credit carryover pools, resource expense pools and scientific research and experimental development expenditure pools. The definition “specified provision” is relevant for the purpose of applying the anti-avoidance rules in subsections 256.1(3) and (6), which deem an acquisition of control of a corporation to have occurred in certain circumstances. For further information, see the commentary on subsections 256.1(3) and (6).

These definitions come into force on March 21, 2013.

Application of subsection (3)

ITA
256.1(2)

New subsection 256.1(2) of the Act provides that subsection 256.1(3), which deems there to have been an acquisition of control of a corporation, applies at a particular time if

- shares of the capital stock of the corporation held by a person, or the total of all shares of the capital stock of the corporation held by members of a group of persons, have at the particular time a fair market value that exceeds 75% of the fair market value of all the shares of the capital stock of the corporation;
- shares of the capital stock of the corporation held by the person, or the total of all shares of the capital stock of the corporation held by members of the group, have immediately before the particular time a fair market value that does not exceed 75% of the fair market value of all the shares of the capital stock of the corporation (this condition ensures that subsection 256.1(3) does not apply more than once solely because the fair market value of the shares owned by the person or group, which is already above 75%, increases in value);
- the person or group does not control the corporation at the particular time; and
- it is reasonable to conclude that one of the main reasons that the person or group does not control the corporation is to avoid the application of one or more specified provisions.

Deemed acquisition of control

ITA
256.1(3)

New subsection 256.1(3) of the Act provides two rules that apply in respect of a corporation for the purpose of applying the attribute trading restrictions. First, paragraph 256.1(3)(*a*) provides that, for the purpose of applying the attribute trading restrictions, the person or group of persons referred to in subsection 256.1(2)

- is deemed to acquire control of the corporation, and each corporation controlled by the corporation, at the particular time. By deeming an acquisition of control of the corporation, and each corporation controlled by it, subsection 256.1(3) causes the attribution trading restrictions to apply to all those corporations; and
- is not deemed to have control of the corporation, and each corporation controlled by the corporation, at any time after the particular time solely because of the application of this provision. As a consequence, the person, or group of persons, referred to in subsection 256.1(2) will not have control of the affected corporations for the purposes of the Act solely because the attribute trading restrictions apply to the affected corporations. *De jure* control would continue to rest with the person, or group of persons, that has such control despite the application of the attribute trading restrictions to the affected corporations. As well, the affected corporations would, in general, continue to be associated with the corporations they were associated with before the application of subsection 256.1(3). For example, the affected corporations would remain part of the *de jure* controller's group for the purpose of deducting the small business deduction and investments tax credits, including refundable scientific research and experimental development tax credits.

Second, paragraph 256.1(3)(*b*) provides that, during the period that the 75% fair market value threshold is satisfied (i.e., the condition in paragraph 256.1(2)(*a*)), each corporation referred to in paragraph 256.1(3)(*a*) – and any corporation incorporated or otherwise formed subsequent to that time and controlled by that corporation – is deemed not to be related to, or affiliated with, any person to which it was related to, or affiliated with immediately before paragraph 256.1(3)(*a*) applies. Accordingly, these corporations cannot undertake loss consolidations within an affiliated, or related, group.

Special rules

ITA
256.1(4)

New subsection 256.1(4) of the Act provides two rules that apply for the purpose of applying the 75% fair market value threshold in respect of a person or group of persons under paragraph 256.1(2)(*a*). First, paragraph 256.1(4)(*a*) provides that, if it is reasonable to conclude that one of the reasons that one or more transactions or events occur is to cause a person, or a group of persons, not to hold shares having a fair market value that exceeds 75% of the fair market value of all the shares of the capital stock of a corporation, paragraph 256.1(2)(*a*) is to be applied without reference to those transactions or events. This rule provides that such transactions or events are to be ignored in determining whether the share holdings of the person or group of persons exceeds 75% of the fair market value of all the shares of the corporation.

Second, paragraph 256.1(4)(*b*) provides that the person, or each member of the group, is deemed to have exercised each right that is held by the person or a member of the group and that is referred to in paragraph 251(5)(*b*) in respect of a share of the corporation referred to in paragraph 256.1(2)(*a*). Accordingly, whether the 75% fair market value threshold in paragraph 256.1(2)(*a*) has been exceeded by a person, or a group, is to be determined on the basis that the person, and each member of a group, has exercised those rights.

If share value nil

ITA
256.1(5)

New subsection 256.1(5) of the Act provides deeming rules that apply in certain circumstances for the purposes of subsections 256.1(2) and (4). The rules provide that, if the fair market value of the shares of the capital stock of a corporation is nil at any time, then for the purpose of determining the fair market value of those shares, the corporation is deemed, at that time, to have assets net of liabilities equal to $100,000 and to have $100,000 of income for the taxation year that includes that time.

Deemed acquisition of control

ITA
256.1(6)

New subsection 256.1(6) of the Act provides an anti-avoidance rule that deems the attribute trading restrictions to apply in certain circumstances. If, at any time as part of a transaction or event or series of transactions or events, control of a particular corporation is acquired by a person, or a group of persons, and it can reasonably be concluded that one of the main reasons for the acquisition of control is so that a specified provision does not apply to one or more corporations, the attribute trading restrictions are deemed to apply to each of those corporations as if control of each of those corporations is acquired at that time.

In general terms, subsection 256.1(6) counters tax avoidance structures under which corporate tax attributes were traded by arm's length persons in circumstances where a corporation (the loss corporation) that has undeducted tax attributes acquires control of a corporation (the profitable corporation) that is profitable. Because the loss corporation (or a person related to or affiliated with it) acquires control of the profitable corporation (or a corporation related to or affiliated with it), the owners of the corporations avoid, subject to the general anti-avoidance rule, an acquisition of control of the loss corporation and the application of the tax attribute trading rules. These structures have generally relied on the Supreme Court of Canada's decision in *Duha Printers (Western) Ltd. v. The Queen,* [1998] 1 SCR 795.

Section 256.1 comes into force on March 21, 2013, except that it does not apply to an event or transaction that occurs

- before March 21, 2013, or
- after March 20, 2013 pursuant to an obligation created by the terms of an agreement in writing entered into between parties before March 21, 2013. For this purpose, parties will be considered not to be obligated if one or more of those parties may be excused from fulfilling the obligation as a result of changes to the Act.

Keeping Canada’s Economy and Jobs Growing Act

Clause 95

Swap transaction

KCEJGA
64(6)(*a*)

The coming-into-force provision for the amendments made in the *Keeping Canada’s Economy and Jobs Growing Act* (S.C. 2011, c. 24) to the definition “swap transaction” in subsection 207.01(1) of the Act is amended to clarify that the Act is to be read without reference to subsection 207.05(4) in determining whether it is reasonable to conclude that the retention of a property in a RRIF or RRSP would result in tax being payable under Part XI.01 of the Act.

Income Tax Regulations

Clause 96

Investment income

ITR
201

Section 201 of the *Income Tax Regulations* (the “Regulations”) imposes a requirement on certain persons to provide annual information returns in respect of investment income, including interest and dividends.

ITR
201(5.1)

Subsection 201(5) of the Regulations requires an insurer to make an information return in prescribed form if the insurer is a party to a life insurance policy in respect of which an amount is required to be included in a taxpayer’s income under the life insurance accrual rules in subsection 12.2(1) or (5) of the Act. Section 205 of the Regulations requires that a return in respect of a calendar year be filed with the Minister of National Revenue by the last day of February of the year following that year.

New subsection 201(5.1) of the Regulations limits an insurer’s obligations under subsection 201(5) in respect of LIA policies. For further information, see the commentary on the definition “LIA policy” in subsection 248(1) of the Act.

An insurer is required to make a return under subsection 201(5) in respect of an LIA policy only if either:

- the insurer is notified in writing – before the end of the calendar year – that the policy is an LIA policy; or
- it is reasonable to conclude that the insurer knew, or ought to have known, before the end of the calendar year, that the policy is an LIA policy.

The notice requirement is met whether the notice is given by the policyholder or by another party acting on behalf of the policyholder.

This amendment applies to taxation years that end after March 20, 2013.

Clause 97

Exempt policies

ITR
306

Section 12.2 of the Act provides for accrual taxation rules in respect of income earned in life insurance policies. Certain life insurance policies, including policies referred to as “exempt policies”, are excluded from this accrual requirement. Section 306 of the Regulations contains rules for determining if a life insurance policy is an exempt policy.

ITR
306(1)

The preamble to subsection 306(1) of the Regulations is amended to ensure that an LIA policy is not considered an exempt policy. For further information, see the commentary on the definition “LIA policy” in subsection 248(1) of the Act.

This amendment applies to taxation years that end after March 20, 2013.

Clause 98

Elections

ITR
600

Section 600 of the Regulations prescribes provisions of the Act for the purposes of obtaining permission to amend, revoke or extend the time to file an election, for which ministerial discretion may be exercised under paragraphs 220(3.2)(*a*) and (*b*) of the Act.

Paragraph 600(*b*) is amended to add a reference to subsection 251.2(6), consequential on the enactment of the loss restriction event rules in new section 251.2 of the Act. For further information, please see the commentary on section 251.2 of the Act.

This amendment comes into force on March 21, 2013.

Clause 99

Prescribed obligation

ITR
806.2

Section 806.2 of the Regulations is amended to replace the cross reference to paragraph 212(1)(*b*) of the Act by a cross reference to the definition “participating debt interest” in subsection 212(3) of the Act. This is consequential on the amendment of paragraph 212(1)(*b*) by Budget 2007.

This amendment comes into force on January 1, 2008.

Clause 100

Capital cost allowance rates

ITR
1100

A portion of the capital cost of depreciable property is deductible as capital cost allowance (CCA) each year. Section 1100 of the Regulations provides rules relating to the deduction of CCA. Subsection 1100(1) of the Regulations sets out the CCA rates that taxpayers may claim with respect to specified classes of depreciable property.

ITR
1100(1)(*a)*(xxvii.2)

Subsection 1100(1) of the Regulations sets out the capital cost allowance (CCA) rates that taxpayers may claim with respect to prescribed classes of depreciable property.

Subsection 1100(1) is amended by adding new subparagraph (*a*)(xxvii.2) to provide a 25% CCA rate for the new Class 41.2 in Schedule II to the Regulations. The new class generally applies to mining property acquired after March 20, 2013.

This amendment applies to taxation years that end after March 20, 2013.

Additional allowances – Class 28 – single mine properties

ITR
1100(1)(*w*)(i)

Subparagraph 1100(1)(*w*)(i) of the Regulations is amended to add references to new paragraphs 1100(1)(*y.2*) and (*ya.2*).

This amendment applies to taxation years that end after March 20, 2013.

Additional allowances – Class 28 – multiple mine properties

ITR
1100(1)(*x*)(i)

Subparagraph 1100(1)(*x*)(i) of the Regulations is amended to add a reference to new paragraph 1100(1)(*ya.2*).

This amendment applies to taxation years that end after March 20, 2013.

Additional allowances – Class 41 – single mine properties

ITR
1100(1)(*y*)(i)

Subparagraph 1100(1)(*y*)(i) of the Regulations is amended to add a reference to new paragraph 1100(1)(*ya.2*).

This amendment applies to taxation years that end after March 20, 2013.

Additional allowances – Class 41.1 – single mine properties

ITR
1100(1)(*y.1*)(i)

Subparagraph 1100(1)(*y.1*)(i) of the Regulations is amended in two respects. First, references to new paragraphs 1100(1)(*y.2*) and (*ya.2*) are added. Second, the description of B in the formula in the paragraph is amended by adding new subparagraph (vi). Subparagraph (vi) ensures the proper operation of the formula in the paragraph by prescribing 0% as the applicable percentage if one or more days in the taxation year are after 2014.

This amendment applies to taxation years that end after March 20, 2013.

Additional allowances – Class 41.1 – single mine properties

ITR
1100(1)(*y.2*)

New paragraph 1100(1)(*y.2*) of the Regulations is added consequential on the introduction of new Class 41.2 in Schedule II to the Regulations. The paragraph provides for the gradual phase-out of the accelerated capital cost allowance (CCA), during the period 2016 to 2021, applicable to mining

property that is a single mine property and for which a separate class is prescribed by new subsection 1101(4g).

Under current rules, accelerated CCA is available in the form of an additional allowance which supplements the regular 25% CCA rate. It allows a taxpayer to deduct, in computing income for a taxation year, up to 100% of the undepreciated capital cost of the mining properties included in the separate Class 41, not exceeding the taxpayer's income for the year from the mine (after deducting regular CCA).

Mining property acquired after March 20, 2013 is generally included in new CCA Class 41.2. New subsection 1101(4g) prescribes a separate class for single mine properties (other than oil sands properties) that are included in paragraph (*a*) of Class 41.2. Properties included in paragraph (*a*) of new Class 41.2 remain eligible for the accelerated CCA until 2016. Beginning with 2017, the accelerated CCA is phased out and the amount of the additional allowance will be reduced each year, regardless of whether the constraint is the income from the mine or the amount of the undepreciated capital cost. The percentage allowed, as accelerated CCA, for each calendar year will be: 90% for 2017, 80% for 2018, 60% for 2019 and 30% for 2020 of the amount otherwise allowable as accelerated CCA. No accelerated CCA will be allowed after 2020 and only the regular 25% CCA rate will apply after 2020.

This amendment applies to taxation years that end after March 20, 2013.

Additional allowances – Class 41.1 – multiple mine properties

ITR
1100(1)(*ya.1*)

Subparagraph 1100(1)(*ya.1*)(i) of the Regulations is amended in two respects. First, a reference to new paragraph 1100(1)(*ya.2*) is added. Second, the description of B in the formula in the paragraph is amended by adding new subparagraph (vi). Subparagraph (vi) ensures the proper operation of the formula in the paragraph by prescribing 0% as the applicable percentage if one or more days in the taxation year are after 2014.

This amendment applies to taxation years that end after March 20, 2013.

Additional allowances – Class 41.2 – multiple mine properties

ITR
1100(1)(*ya.2*)

New paragraph 1100(1)(*ya.2*) of the Regulations is added consequential on the introduction of new Class 41.2 in Schedule II to the Regulations. This paragraph provides for the gradual phase-out of the accelerated capital cost allowance (CCA), during the period 2016 to 2021, applicable to mining property (other than an oil sands property) that is a multiple mine property and for which a separate class is prescribed by new subsection 1101(4h).

Under current rules, accelerated CCA is available in the form of an additional allowance which supplements the regular 25% CCA rate. It allows a taxpayer to deduct, in computing income for a taxation year, up to 100% of the undepreciated capital cost of the properties included in the separate Class 41, not exceeding the taxpayer's income for the year from the mine (after deducting regular CCA).

Mining property acquired after March 20, 2013 is generally included in new CCA Class 41.2. New subsection 1101(4h) prescribes a separate class for multiple mine properties that are included in paragraph (*a*) of Class 41.2. Properties included in paragraph (*a*) of new Class 41.2 remain eligible for the accelerated CCA until 2016. Beginning with 2017, the accelerated CCA is phased out and the amount of the additional allowance will be reduced each year, regardless of whether the constraint is the income from the multiple mines or the amount of the undepreciated capital cost. The percentage allowed, as accelerated CCA, for each calendar year will be: 90% for 2017, 80% for 2018, 60% for 2019 and 30% for 2020 of the amount otherwise allowable as accelerated CCA. No accelerated CCA will be allowed after 2020 and only the regular 25% CCA rate will apply after 2020.

This amendment applies to taxation years that end after March 20, 2013.

Capital cost allowance – deductions allowed

Subsections 1100(11), (15) and (24) of the Regulations limit the amount of CCA that a taxpayer may deduct because of subsection 1100(1) of the Regulations. These limits are intended to prevent taxpayers from sheltering other sources of income with losses created by CCA related to "rental property", "leasing property" and "specified energy property". Exceptions to these limits are provided by subsections 1100(12), (16), (25) and (26), and are generally in respect of principal business corporations and partnerships all of whose members are principal business corporations.

As explained below, the principal business exceptions in subsections 1100(12), (16), (25) and (26) are amended to extend those exceptions to tiered partnerships: that is, partnerships all of whose members are, throughout the fiscal period of the partnership, principal business corporations or other partnerships to which the exception applies.

A tax shelter, in common parlance (i.e., without reference to the definition in section 237.1 of the Act), is an investment or expenditure of a taxpayer that provides a deduction from income for tax purposes in respect of its cost that is in excess of the economic consumption of the relevant asset. The excess deduction will, absent limiting provisions in the income tax law, shelter income from taxation. An example would be CCA from efficient and renewable energy generation equipment that exceeds economic depreciation. Various provisions in the Act and Regulations limit such deductions, generally in situations where the income being sheltered is from a source other than the property itself or where the cost to the taxpayer might be mitigated through financing arrangements, revenue guarantees or other benefits.

In the case of the rules limiting CCA claims in respect of rental property and leasing property, the exception for principal business corporations reflects the policy that the limitation should not apply to a taxpayer who uses the property in an active business that earns substantially all its gross revenue from that property and similar property. The exception in respect of specified energy property is slightly different in that it applies if the principal business of the corporation is manufacturing or processing, mining or, in general, energy production.

These exceptions are permitted for principal business corporations (and partnerships the members of which are principal business corporations) because a principal business corporation is not an individual with other sources of income or a flow-through entity through which losses from the property might otherwise be allocated to other entities. As such, the use of a principal business corporation as a vehicle through which another person might invest in a rental property, leasing property or specified energy property, is considered an acceptable method for avoiding the application of these rules to limit CCA. This is, however, based on the expectation that the corporation is created

as a going concern and not as a flow-through entity. If the intention or expectation of a taxpayer, in incorporating a principal business corporation through which to invest, is to incur for tax purposes losses in the corporation that could then be transferred to the taxpayer or to another person (whether by wind-up, amalgamation or any other series of transactions), the claiming of the losses by the taxpayer or other person would defeat the object of the rules that restrict the CCA deductions available in certain circumstances (unless the taxpayer or other person were also a principal business corporation).

Rental property

ITR
1100(12)(*b*)

Subsection 1100(12) of the Regulations provides an exception to the rule in subsection 1100(11) of the Regulations. Subsection 1100(11) limits the amount of CCA that a taxpayer may deduct because of subsection 1100(1) of the Regulations in respect of "rental property". The deduction of CCA in respect of rental property owned by the taxpayer is generally limited to the amount, calculated without any allowance for CCA, by which the taxpayer's income from renting or leasing a rental property exceeds the taxpayer's loss from renting or leasing a rental property. "Rental property" for this purpose is defined in subsection 1100(14) to generally mean property owned by a taxpayer that is used principally for the purpose of gaining or producing gross revenue that is rent and that is

- a building; or
- a leasehold interest in real property, if the leasehold interest is property included in CCA Classes 1, 3, 6 or 13 in Schedule II to the Regulations.

The exception in subsection 1100(12) applies to life insurance corporations and certain principal business corporations. This exception extends to partnerships all of whose members are those excepted corporations. Paragraph 1100(12)(*b*) is amended to extend the exception to partnerships all of whose members are those excepted corporations or other partnerships that are excepted from application of the limitation in subsection 1100(11).

This amendment applies to fiscal periods that end after October 2010.

Leasing property

ITR
1100(16)(*b*)

Subsection 1100(16) of the Regulations provides an exception to the rule in subsection 1100(15) of the Regulations. Subsection 1100(15) limits the amount of CCA that a taxpayer may deduct under subsection 1100(1) of the Regulations in respect of "leasing property". The deduction of CCA in respect of leasing property owned by the taxpayer is generally limited to the amount, calculated without any allowance for CCA, by which the taxpayer's income from renting, leasing or earning royalties from leasing property exceeds the taxpayer's loss from renting, leasing or earning royalties from leasing property. "Leasing property" for this purpose is defined in subsection 1100(17) of the Regulations to generally mean certain depreciable property, other than rental property and computer tax shelter property, owned by a taxpayer that is used principally for the purpose of gaining or producing gross revenue that is rent, royalty or leasing revenue.

The exception in subsection 1100(16) applies to certain principal business corporations and to partnerships all the members of which are those principal business corporations. Paragraph

1100(16)(*b*) is amended to extend the exception to a partnership all of whose members are, throughout the fiscal period of the partnership, principal business corporations described in paragraph 1100(16)(*a*) or other partnerships to which paragraph 1100(16)(*b*) applies.

This amendment applies to fiscal periods that end after October 2010.

Specified energy property

ITR
1100(24) to (29)

Subsections 1100(24) to (29) of the Regulations provide rules that restrict CCA claims with respect to "specified energy property".

ITR
1100(25)(*b*)(iv)

Subsection 1100(25) of the Regulations describes a "specified energy property", in general, as efficient and renewable energy generation equipment included in CCA Class 34, 43.l, 43.2, 47 or 48 in Schedule II to the Regulations.

Paragraphs 1100(25)(*a*) and (*b*) exclude certain properties from the meaning of specified energy property. Subparagraph 1100(25)(*b*)(iv) generally excludes property leased in the year to certain persons or partnerships if the owner of the property was a principal business corporation described in paragraph 1100(25)(*b*)(iii) or a partnership each member of which was a principal business corporation described in subparagraph 1100(25)(*b*)(iii) or paragraph 1100(26)(*a*). Subparagraph 1100(25)(*b*)(iv) is amended to extend its application to partnerships all of whose members are, throughout the fiscal period of the partnership, principal business corporations described in paragraph 1100(25)(*b*)(iii) or partnerships to which subparagraph 1100(25)(*b*)(iv) applies.

This amendment applies to fiscal periods that end after October 2010.

ITR
1100(26)(*b*)

Subsection 1100(26) of the Regulations provides an exception to the rule in subsection 1100(24) of the Regulations. Subsection 1100(24) limits the amount of CCA that a taxpayer may deduct under subsection 1100(1) of the Regulations in respect of "specified energy property". This limitation may restrict the extent to which the owners of such property benefit from an accelerated CCA rate.

The exception in subsection 1100(26) applies to certain principal business corporations described by paragraph 1100(26)(*a*) and to partnerships, all of whose members are certain principal business corporations. Paragraph 1100(26)(*b*) is amended to extend the exception to partnerships all of whose members are, throughout the fiscal period of the partnership, principal business corporations described in paragraph 1100(26)(*a*) or partnerships to which paragraph 1100(26)(*b*) applies.

This amendment applies to fiscal periods that end after October 2010.

Clause 101

Separate classes – businesses and properties

ITR
1101

Section 1101 of the Regulations provides separate classes in respect of certain properties that are described in Schedule II to the Regulations and used to earn income. Section 1101 is amended to introduce new subsections 1101(4g) and (4h).

Single mine property – Class 41.2

ITR
1101(4g)

New subsection 1101(4g) of the Regulations provides for a separate class for single mine properties that are included in paragraph (*a*) of new Class 41.2 in Schedule II to the Regulations.

This amendment applies to taxation years that end after March 20, 2013.

Multiple mine property – Class 41.2

ITR
1101(4h)

New subsection 1101(4h) of the Regulations provides for a separate class for multiple mine properties that are included in paragraph (*a*) of new Class 41.2 in Schedule II to the Regulations.

This amendment applies to taxation years that end after March 20, 2013.

Clause 102

Special property rules

Electrical plant used for mining

ITR
1102(8) and (9)

Paragraphs 1102(8)(*d*) and (9)(*d*) of the Regulations allow certain taxpayers to elect to have property that would otherwise be included in Class 41 in Schedule II to the Regulations to instead be included in Class 43.1 or 43.2, as the case may be. These paragraphs are amended to add a reference to new Class 41.2. These amendments apply to property acquired after March 20, 2013.

The coming-into-force provisions for these amendments provide that the election referred to in paragraph 1102(8)(*d*) or (9)(*d*), made by a taxpayer in respect of an eligible mine development property (as defined in subsection 1104(2)), or a property described in the new Class 41.2, is deemed to have been filed in the manner described in the paragraphs for the taxation year in which the property was acquired if the election is filed with the Minister in writing on or before the day that is 180 days after the day on which this provision receives Royal Assent. This ensures that, where a taxpayer has acquired property after March 20, 2013 and before the day this provision receives Royal Assent, the taxpayer has at least 180 days to make the election referred to in the paragraphs.

Railway companies

ITR
1102(10)

Subsection 1102(10) of the Regulations prescribes the capital cost allowance class that applies when section 36 of the Act deems an expenditure made by a railway company to have been the acquisition of a depreciable property.

Subsection 1102(10) and the heading before it are repealed consequential on the repeal of section 36 of the Act. For further information, please see the commentary on section 36.

This repeal applies to expenditures incurred in taxation years that begin after December 21, 2012.

Property acquired by transfer, amalgamation or winding-up

ITR
1102(14)

Subsection 1102(14) of the Regulations ensures that properties acquired by a taxpayer under certain circumstances remain properties of the same class as that of the person from whom the taxpayer acquired the property.

Subsection 1102(14) is amended to add a reference to new subsection (14.12) to ensure that, if applicable, the new rule in subsection 1102(14.12) supersedes the rule in subsection 1102(14).

This amendment applies to property acquired after March 20, 2013.

ITR
1102(14.12)

New subsection 1102(14.12) of the Regulations is introduced to ensure that the undepreciated capital cost (UCC) pool of a mining property (other than an oil sands property) included in Class 41 is preserved, for the purpose of deducting an additional capital cost allowance (CCA) under the Regulations, in circumstances where subsection 1102(14) applies.

Generally, a mining property acquired after March 20, 2013 is to be included in new Class 41.2. Subsection 1102(14.12), however, ensures that where a Class 41 property is acquired in circumstances to which subsection 1102(14) applies, the additional accelerated CCA will continue to be available to the extent of the UCC pool of the vendor.

Paragraph 1102(14.12)(*a*) provides for a rollover of the reduction in the UCC of Class 41 of the vendor to the UCC of Class 41 of the purchaser. Paragraph 1102(14.12)(*b*) provides that the amount by which the reduction in the UCC of Class 41 of the vendor exceeds the opening UCC balance of the vendor is to be included in Class 41.2 of the purchaser.

The accelerated CCA in the form of an additional allowance supplements the regular CCA rate for Class 41 property. The additional allowance allows a taxpayer to deduct in computing income for a taxation year up to 100% of the UCC of the properties included in the separate Class 41, not exceeding the taxpayer’s income for the year from the mine (after deducting regular CCA).

The accelerated CCA is available in full until 2016 for property included in paragraph (*a*) of Class 41.2. After 2016, the accelerated CCA is gradually phased out during the 2017-2020 period. The percentage allowed for each of those calendar years will be: 90% for 2017, 80% in 2018, 60% in 2019

and 30% in 2020 of the amount otherwise allowable as accelerated CCA. No accelerated CCA will be allowed after 2020 and only the regular 25% CCA rate will apply after 2020.

This amendment applies to property acquired after March 20, 2013.

Clause 103

Capital cost allowance – interpretation

ITR
1104

Section 1104 of the Regulations sets out various definitions that apply for the purpose of determining the capital cost allowance (CCA) for a taxation year in respect of a depreciable property of a taxpayer.

Section 1104 is amended consequential on the introduction of Class 41.2 in Schedule II to the Regulations applicable to mining property acquired after March 20, 2013, and consequential on the amendments made to Classes 43.1 and 43.2 to expand Class 43.2 by making biogas production equipment that uses more types of organic waste eligible for inclusion in Class 43.2 and to expand the range of cleaning and upgrading equipment that can be used to treat eligible gases.

Definitions

ITR
1104(2)

Subsection 1104(2) of the Regulations sets out definitions that apply for the purposes of Part XI of the Regulations and Schedule II to the Regulations.

Subsection 1104(2) is amended to add the definition "eligible mine development property". The definition is relevant for the phase-out of accelerated CCA for property used in mining projects (other than oil sands projects) and the consequential introduction of Class 41.2. Eligible mine development property can be included in Class 41 rather than in the new Class 41.2 (i.e., accelerated CCA continues to be available, without any phase-out, in respect of eligible mine development property acquired by a taxpayer after March 20, 2013 and before 2018).

This phase-out of accelerated CCA does not apply to the property used in an oil sands project. The accelerated CCA for oil sands property is already being phased-out based on the schedule set out in the Budget 2007 amendments to subsection 1104(2).

Eligible mine development property means a property acquired by a taxpayer for the purpose of gaining or producing income

- from a new mine or an expansion of a mine, if the property was acquired under a written agreement entered into by the taxpayer before March 21, 2013,
- from a new mine, if either the construction of the new mine or the engineering and design work for the construction of the new mine was started by, or on behalf of, the taxpayer before March 21, 2013, or
- from an expansion of a mine, if either the construction for the expansion of the mine or the engineering and design work for the construction of the expansion of the mine was started by, or on behalf of, the taxpayer before March 21, 2013.

For the purposes of this definition neither construction nor engineering and design work include obtaining permits or regulatory approvals, conducting environmental assessments, community consultations or impact benefit studies, and similar activities. In addition evidence in support of the initiation of the engineering and design work for the construction must be in writing.

This definition comes into force on March 21, 2013.

Mining

ITR
1104(5)

Subsection 1104(5) of the Regulations describes the expression “income from a mine” or any expression referring to a taxpayer’s income from a mine.

Subsection 1104(5) is amended to add references to new paragraphs 1100(1)(*y.2*) and (*ya.2*), to new subsections 1101(4g) and (4h), and to the new Class 41.2 in Schedule II to the Regulations. This ensures that the description of the expression “income from a mine” or any expression referring to a taxpayer’s income from a mine in subsection 1104(5) also apply for the purposes of these new provisions.

This amendment comes into force on March 21, 2013.

Gross revenue from a mine

ITR
1104(5.1)

Subsection 1104(5.1) of the Regulations describes the expression “gross revenue from a mine” for the purposes of Classes 41 and 41.1 of Schedule II to the Regulations.

Subsection 1104(5.1) is amended by adding a reference to new Class 41.2. This ensures that the description of the expression “gross income from a mine” in subsection 1104(5.1) applies for the purposes of the new Class 41.2.

This amendment comes into force on March 21, 2013.

Mine

ITR
1104(7)

Subsection 1104(7) of the Regulations describes a mine for certain provisions of the Regulations.

Subsection 1104(7) is amended to add references to new paragraphs 1100(1)(*y.2*) and (*ya.2*), to new subsections 1101(4g) and (4h), and to new Class 41.2 in Schedule II to the Regulations. This ensures that the description of a mine also applies for the purposes of these new provisions.

This amendment comes into force on March 21, 2013.

Production

ITR
1104(8.1)

Subsection 1104(8.1) of the Regulations clarifies that any reference to the word "production" means – for the purposes of paragraphs (*c*) and (*e*) of Class 28 and paragraph (*a*) of Classes 41 and 41.1 in Schedule II to the Regulations – production in reasonable commercial quantities.

Subsection 1104(8.1) is amended to add a reference to new Class 41.2. This ensures that for the purposes of new Class 41.2 production also means production in reasonable commercial quantities.

This amendment comes into force on March 21, 2013.

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 per year on a declining balance basis) and Class 43.2 (50% CCA rate on a declining balance basis) in Schedule II to the Regulations. The biogas production equipment that is currently included in Class 43.2 is limited to equipment using organic waste that is sludge from an eligible sewage treatment facility, food and animal waste, manure, plant residue or wood waste.

Subsection 1104(13) is amended in three respects. First, the definition "biogas" is amended to add references to pulp and paper by-product and separated organics. Second, the definition "food and animal waste" is amended to add references to beverages. Third, new definitions of "pulp and paper by-product" and "separated organics" are introduced. These amendments provide that pulp and paper by-product, beverage industry waste (including wastewater) and separated organics from municipal waste can be used in qualifying biogas production equipment described in paragraph (*b*) of Class 43.2 because they are described in subparagraph (*d*)(xiii) of Class 43.1.

These amendments generally apply in respect of property acquired after March 20, 2013 that has not been used or acquired for use before March 21, 2013. The new definitions "pulp and paper by-product" and "separated organics" come into force on March 21, 2013.

Clauses 104 and 105

Communication of information

ITR
3003(*c*)
Part XXX

Sections 3003 and 3004 of the Regulations prescribe provincial laws for the purposes of paragraph 122.64(2)(*a*) and subparagraph 241(4)(*j.1*)(ii) of the Act, which allow certain information to be provided to an official of the government of a province, solely for the purposes of the administration or enforcement of the prescribed laws.

Paragraph 3003(*c*) of the Regulations is amended to replace the reference to *An Act respecting Income Support, Employment Assistance and Social Solidarity*, R.S.Q., c. S-32.001 with a reference to the *Individual and Family Assistance Act*, R.S.Q., c. A-13.1.1. This amendment comes into force on January 1, 2007.

Part XXX of the Regulations is repealed consequential on the repeal of section 122.64 of the Act and the repeal of *An Act respecting Family Benefits*, R.S.Q, c. P-19.1. This amendment is concurrent with the amendment to paragraph 241(4)(*j.1*) of the Act, the introduction of new subsection 241(4)(*j.2*) of the Act and the introduction of new section 6500 of the Regulations.

The repeal of Part XXX comes into force on Royal Assent.

Clause 106

Investment tax credits

ITR
Part XLVI

Part XLVI of the Regulations provides rules that are generally applicable 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 regime. Section 4600 is amended to add references to new Class 41.2 in Schedule II to the Regulations.

Qualified property

ITR
4600(1)(*b*)

Subsection 4600(1) of the Regulations sets out what is a prescribed building for the purposes of the definition “qualified property” in subsection 127(9) of the Act. The cost of a qualified property is included in the definition “investment tax credit” in subsection 127(9) of the Act. A deduction may be claimed, under subsection 127(5) of the Act, in respect of an investment tax credit against tax otherwise payable by a taxpayer.

Paragraph 4600(1)(*b*) is amended to add a reference to new Class 41.2 in Schedule II to the Regulations.

This amendment applies to property acquired after March 20, 2013.

ITR
4600(2)(*j*)

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. The cost of a qualified property is included in the definition “investment tax credit” in subsection 127(9) of the Act. A deduction may be claimed, under subsection 127(5) of the Act, in respect of an investment tax credit against tax otherwise payable by a taxpayer.

Paragraph 4600(2)(*j*) is amended to add a reference to new Class 41.2 in Schedule II to the Regulations.

This amendment applies to property acquired after March 20, 2013.

Clauses 107 and 108

Prescribed property

ITR
4900(15)

Part XLIX

New subsection 4900(15) of the Regulations is introduced to replace existing section 5001 of the Regulations. This amendment is consequential on the repeal of Part L of the Regulations. The text of new subsection 4900(15) is the same as that of existing section 5001. Additionally, the heading before section 4900 of the Regulations is amended to better reflect the contents of Part XLIX of the Regulations.

These amendments come into force on March 23, 2011.

Clause 109

Excluded property

ITR
Part L

Part L of the Regulations is repealed. The contents of section 5000 of the Regulations are moved to the new definition "excluded property" in subsection 207.01(1) of the Act. For further information, please see the commentary on that definition. As well, the rule in section 5001 of the Regulations is moved to new subsection 4900(15) of the Regulations as described above.

This amendment comes into force on March 23, 2011.

Clause 110

Definitions

ITR
5204

Section 5204 of the Regulations provides a number of definitions that apply for the purpose of calculating Canadian manufacturing and processing profits in circumstances in which a corporation is a member of a partnership.

"gross cost"

The definition "gross cost" in section 5204 is used in applying the definitions "cost of labour" and "cost of capital" in that section.

The reference to the term "majority interest partner" in the English version of the definition "gross cost" in section 5204 is replaced with a reference to "majority-interest partner". This amendment is consequential on a similar amendment to the definition "majority-interest partner" in subsection 248(1) of the Act. For further information, see the commentary on that definition.

The definition is also amended to reflect the current drafting style.

This amendment comes into force on Royal Assent.

Clause 111

Prescribed distributions

ITR
5600

Section 5600 of the Regulations prescribes foreign spin-off distributions for the purposes of the foreign spin-off tax-deferred distribution rule in section 86.1 of the Act. Section 86.1 requires that various conditions be met before a distribution is considered to be an "eligible distribution". The various conditions ensure, among other things, that Canadian shareholders of a foreign corporation are not treated more favourably with respect to a foreign distribution than Canadian shareholders receiving similar distributions from a Canadian corporation.

Certain distributions under the U.S. *Internal Revenue Code* are considered acceptable without the need for prescription, and this result is provided for in subsection 86.1(2) of the Act. Because there is not the same familiarity with the way in which other countries approach the taxation of spin-off transactions, there is the additional requirement that a non-U.S. foreign spin-off be prescribed. Section 5600 is amended to prescribe the following foreign spin-off distributions:

- the distribution by Fiat S.p.A. of Italy, to its common shareholders, of common shares of Fiat Industrial S.p.A. of Italy on January 1, 2011;
- the distribution by Foster's Group Limited of Australia, to its common shareholders, of common shares of Treasury Wine Estates Limited of Australia on May 9, 2011; and
- the distribution by Telecom Corporation of New Zealand Limited, to its common shareholders, of common shares of Chorus Limited of New Zealand on November 30, 2011.

This amendment comes into force on January 1, 2011.

Clause 112

Prescribed laws

ITR
6500

New section 6500 of the Regulations, which prescribes provincial laws for the purposes of new paragraph 241(4)(*j.2*) of the Act, replaces section 3003 of the Regulations. Paragraph 241(4)(*j.2*) permits income tax information relating to taxpayers obtained under the Canada child tax benefit provisions of the Act by the Canada Revenue Agency to be shared with provincial governments for the purpose of administering a prescribed provincial law.

Section 6500 prescribes two laws of Quebec:

- *An Act respecting the Québec Pension Plan*, R.S.Q., c. R-9; and
- *Individual and Family Assistance Act*, R.S.Q., c. A-13.1.1, as it relates to the additional amounts for dependent children.

This amendment comes into force on Royal Assent.

Clause 113

Prescribed labour-sponsored venture capital corporation

ITR
6701.1

Section 6701 of the Regulations prescribes, for certain purposes of the Act, that corporations that are established or registered under certain provincial statutes, or are registered under section 204.81 of the Act, will be considered "prescribed labour-sponsored venture capital corporations" (prescribed LSVCCs).

New section 6701.1 is added, concurrent with the phase-out of the labour-sponsored funds tax credit and the amendment of section 204.81 of the Act, to prevent a corporation that has not submitted its application for registration under one of the provincial statutes listed in section 6701 prior to March 21, 2013 from qualifying as a prescribed LSVCC for the purposes of the labour-sponsored funds tax credit.

New section 6701.1 comes into force on March 21, 2013.

Clause 114

Prescribed energy conservation property

ITR
8200.1

Section 8200.1 of the Regulations provides that, for the purposes of subsection 13(18.1) and subparagraph 241(4)(*d*)(vi.1) of the Act, "prescribed energy conservation property" means property described in capital cost allowance Classes 43.1 and 43.2 in Schedule II to the Regulations.

Section 8200.1 is amended to add a cross reference to the definition "Canadian renewable and conservation expense" (CRCE) in subsection 66.1(6) of the Act. This amendment ensures that the prescription of property in the section applies for the purposes of the definition CRCE.

This amendment comes into force on December 21, 2012.

Clause 115

Prescribed international organizations

ITR
8900(1)

Subsection 8900(1) of the Regulations prescribes the United Nations and its specialized agencies as international organizations for the purposes of the deduction under subparagraph 110(1)(*f*)(iii) of the Act. This subsection is amended to also prescribe those organizations as international organizations for the purposes of paragraph 126(3)(*a*) of the Act. This amendment clarifies that, consistent with the deduction for income from employment with a "prescribed international organization" (such as the United Nations or its specialized agencies) in subparagraph 110(1)(*f*)(iii), a credit is not available under subsection 126(3) in respect of income from employment with the United Nations or its specialized agencies.

This amendment applies to the 2013 and subsequent taxation years.

Clauses 116 to 119

Capital cost allowance – prescribed classes

ITR
Schedule II

Schedule II to the Regulations lists the properties that can be included in each capital cost allowance (CCA) class. A portion of the capital cost of depreciable property is deductible as CCA each year. CCA rates for each type of property, identified by their CCA classes, are set out in section 1100 of the Regulations.

Class 10 (30% rate)

The mid-amble in Class 10 (30% CCA rate) in Schedule II to the Regulations that is after paragraph (*f.2*) and before paragraph (*g*) is amended to add a reference to new Class 41.2.

This amendment applies to property acquired after March 20, 2013.

Class 41 (25% rate)

The preamble to Class 41 (25% CCA rate) in Schedule II to the Regulations is amended to add a reference to new Class 41.2. This amendment ensures that Class 41 does not apply to mining property included in Class 41.2. Class 41.2 only applies to property that would otherwise be included in paragraph (*a*) or (*a.1*) of Class 41, if the property was acquired before March 21, 2013. Eligible mine development property acquired after March 20, 2013 and before 2018 can be included in Class 41. Property that is generally not eligible for accelerated CCA (i.e., property described in paragraphs (*a.3*) to (*d*)) of Class 41 will also continue to be included in Class 41. Paragraph (*a.2*) of Class 41 applies only in respect of oil sands property. The accelerated CCA for oil sands property is already being phased-out based on the schedule set out in the Budget 2007 amendments to subsection 1104(2).

This amendment applies to property acquired after March 20, 2013.

Class 41.2 (25% rate)

New Class 41.2 (25% CCA rate) in Schedule II to the Regulations includes mining property acquired after March 20, 2013, other than oil sands property or eligible mine development property. Paragraph (*a*) of Class 41.2 includes mining property acquired after March 20, 2013 and before 2021 that, if the property had been acquired before March 21, 2013, would have been included in paragraph (*a*), (*a.1*) or (*a.2*) of Class 41. Paragraph (*b*) of Class 41.2 includes mining property acquired after 2020 that, if the property had been acquired before March 21, 2013, would have been included in paragraph (*a*), (*a.1*) or (*a.2*) of Class 41.

Under current rules, accelerated CCA is available in the form of an additional allowance which supplements the regular 25% CCA rate. It allows a taxpayer to deduct, in computing income for a taxation year, up to 100% of the undepreciated capital cost of the properties included in the separate Class 41, not exceeding the taxpayer's income for the year from the mine (after deducting regular CCA).

As discussed in the commentary on new subsections 1101(4g) and (4h), these subsections prescribe separate classes for certain properties that are included in paragraph (*a*) of Class 41.2. These separate classes of properties remain eligible for the full accelerated CCA until 2016. Beginning with 2017, accelerated CCA is phased out and the amount of the additional allowance will be reduced each year, regardless of whether the constraint is the level of project income or the amount of the undepreciated

capital cost. The percentage allowed, as accelerated CCA, in each calendar year will be 90% for 2017, 80% for 2018, 60% for 2019 and 30% for 2020 of the amount otherwise allowable as accelerated CCA. No accelerated CCA will be allowed and only the regular 25% CCA rate will apply for assets in this Class after 2020.

Eligible mine development property acquired after March 20, 2013 and before 2018 can be included in Class 41.

This amendment comes into force on March 21, 2013.

Class 43.1 (30% rate) and 43.2 (50% rate)

Class 43.1 in Schedule II to the Regulations currently provides an accelerated 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 for Class 43.1).

Class 43.1 (and indirectly Class 43.2) is amended to expand Class 43.2 with respect to the biogas equipment and equipment used to treat eligible gases from waste to produce biomethane that is eligible for inclusion in those classes.

ITR
Class 43.1 (*d*)(viii)

Subparagraph (*d*)(viii) of Class 43.1 in Schedule II to the Regulations currently describes equipment used primarily for the purpose of collecting and storing landfill gas or digester gas. Biomethane can be obtained by cleaning and upgrading landfill gas or digester gas. The equipment described in subparagraph (*d*)(viii) also includes ancillary equipment used to remove non-combustibles and contaminants from landfill gas or digester gas.

Subparagraph (*d*)(viii) is amended to expand the range of cleaning and upgrading equipment that can be used to treat eligible gases from waste by replacing the reference to “other ancillary equipment” with “related equipment,” as that reference applies to the equipment used to collect, store, clean or upgrade landfill or digester gas.

This amendment applies in respect of property acquired after March 20, 2013 that has not been used or acquired for use before March 21, 2013.

ITR
Class 43.1 (*d*)(xiii)

Subparagraph (*d*)(xiii) currently describes property that is part of a system that is used primarily to produce and store biogas. The property described in subparagraph (*d*)(xiii) includes equipment that is an anaerobic digester reactor, a buffer tank, a pre-treatment tank, biogas piping, a biogas storage tank and a biogas scrubbing equipment. Biomethane can be obtained by cleaning and upgrading biogas. The equipment described in subparagraph (*d*)(xiii) only includes biogas scrubbing equipment and does not include any other equipment that can be used to remove non-combustibles and contaminants from biogas.

Subparagraph (*d*)(xiii) is amended to expand the range of cleaning and upgrading equipment that can be used to treat eligible gases from waste by replacing the reference to "biogas scrubbing equipment" with "equipment used to remove non-combustibles and contaminants from the gas". In addition the list of equipment that can be included in subparagraph (*d*)(xiii) is expanded to include fans, compressors and heat exchangers.

This amendment applies in respect of property acquired after March 20, 2013 that has not been used or acquired for use before March 21, 2013.

Clause 120

Coordinating amendment

This provision coordinates the amendment to clause 37(6.1)(*a*)(i)(B) with an amendment to that clause contained in subsection 9(5) of the *Jobs and Growth Act, 2012* (S.C. 2012, c. 31).

Part 2

Amendments to the Excise Tax Act

Clause 121

Electronic Suppression of Sales – Administrative Monetary Penalties

ETA
285.01

New section 285.01 of the *Excise Tax Act* (the Act) provides for administrative monetary penalties in relation to electronic suppression of sales software or devices that are, or are intended to be, capable of being used in relation to records that are required to be kept under section 286 of the Act. These new penalties are in addition to other penalties that may be assessed under the Act.

New section 285.01 comes into force on the later of January 1, 2014 and the day of royal assent to the enacting legislation.

Definitions

ETA
285.01(1)

New subsection 285.01(1) defines the terms “electronic cash register” and “electronic suppression of sales device” for the purposes of section 285.01.

“electronic cash register”

New definition “electronic cash register” generally means an electronic device or computer system designed to record transaction data or any other electronic point-of-sale system.

“electronic suppression of sales device”

New definition “electronic suppression of sales device” (ESS device) generally means a software program that falsifies the records of electronic cash registers or a hidden programming option in an electronic cash register that may be used to create a virtual second till or to eliminate or manipulate transaction records in the electronic cash register.

Penalties

ETA
285.01(2), (3) and (4)

New subsection 285.01(2) imposes a penalty on every person that uses an ESS device or a similar device or software or that under circumstances attributable to neglect, carelessness or wilful default, participates in, assents to or acquiesces in the use of an ESS device or similar device or software. New subsection 285.01(3) imposes a penalty on every person that acquires or possesses an ESS device or a right in respect of an ESS device. On the first penalty in relation to the use, acquisition or possession of an ESS device imposed on the person under this Act or the *Income Tax Act*, the amount of the penalty is $5,000. If the person has already been assessed a penalty in relation to an ESS device under either Act, the penalty for any subsequent use, acquisition or possession by the person of an ESS device is $50,000.

New subsection 285.01(4) imposes a penalty on every person that designs, develops, manufactures, sells, possesses for sale, offers for sale, transfers or otherwise makes available an ESS device or that supplies installation, upgrade or maintenance services for an ESS device. On the first penalty in relation to the manufacturing or making available of an ESS device imposed to the person under this Act or the *Income Tax Act*, the amount of the penalty is $10,000, if the person has not already been assessed a penalty in relation to an ESS device under either Act. If it is the first penalty in relation to the manufacturing or making available of an ESS device, but another penalty in relation to the use, acquisition or possession of an ESS device has previously been assessed under either Act, the amount of the penalty is $50,000. If a penalty in relation to the manufacturing or making available of an ESS device has previously been assessed to the person under either Act, the amount of the penalty is $100,000.

Limitation

ETA
285.01(5)

New subsection 285.01(5) provides a limitation with respect to the assessment of multiple penalties under this section. This subsection provides that if the Minister of National Revenue assesses a penalty under this section, the Minister is not to assess another penalty payable by the person in respect of an action that relates to an ESS device that occurred before that penalty was assessed.

Due Diligence

ETA
285.01(6) and (7)

New subsection 285.01(6) provides that, unless specifically provided by new subsection 285.01(7), a due diligence defence is not available in relation to penalties imposed under section 285.01.

New subsection 285.01(7) provides that, in the case of penalties imposed under new subsections 285.01(3) and (4), a person is not liable in respect of an action of the person if the person exercised the degree of care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances to prevent that action from occurring.

Assessment Vacated

ETA
285.01(8)

New subsection 285.01(8) provides that, for the purposes of new section 285.01, if an assessment of a penalty under this section is vacated, the penalty is deemed to have never been assessed. This would mean, for example, that if an assessment of a penalty is vacated, that assessment would no longer trigger the limitation provided for in new subsection 285.01(5).

Clause 122

Period for Assessment

ETA
298(1)(*e*)

Subsection 298(1) of the Act sets out the limitation periods for assessments and reassessments of amounts under Part IX of the Act. Paragraph 298(1)(*e*) establishes that if a person is liable to pay a

penalty, other than a penalty under sections 280, 285 or 285.1 of the Act, the person may not be assessed in respect of the penalty more than four years from when the person became liable.

The amendment to paragraph 298(1)(*e*) adds a reference to the new penalty imposed under new section 285.01 of the Act in the list of provisions not subject to the limitation period provided for in this paragraph.

The amendment comes into force on the later of January 1, 2014 and the day of royal assent to the enacting legislation.

Clause 123

Electronic Suppression of Sales – Offences

ETA
327.1

New section 327.1 of the Act sets out offences in relation to electronic suppression of sales software or devices (ESS device) that are, or are intended to be, capable of being used in relation to records that are required to be kept under section 286 of the Act.

New section 327.1 comes into force on the later of January 1, 2014 and the day of royal assent to the enacting legislation.

Definitions

ETA
327.1(1)

New subsection 327.1(1) provides that the definitions in subsection 285.01(1) of the Act apply in section 327.1. For more information, refer to the commentary for new subsection 285.01(1).

Offences

ETA
327.1(2) to (5)

New subsection 327.1(2) provides that every person is guilty of an offence if that person, without lawful excuse, the proof of which lies on the person,

a) uses an ESS device or a similar device or software in relation to records that are required to be kept under section 286 of the Act,

b) acquires or possesses an ESS device, or a right in respect of an ESS device, that is, or is intended to be, capable of being used in relation to records that are required to be kept under section 286,

c) designs, develops, manufactures, possesses for sale, offers for sale, sells, transfers or otherwise makes available to another person an ESS device that is, or is intended to be, capable of being used in relation to records that are required to be kept under section 286,

d) supplies installation, upgrade or maintenance services for an ESS device that is, or is intended to be, capable of being used in relation to records that are required to be kept under section 286, or

e) participates in, assents to or acquiesces in the commission of, or conspires with any person to commit any of the offences described above.

In addition to any penalty otherwise provided, the person is liable on summary conviction, to a fine of not less than $10,000 and not more than $500,000, or to imprisonment for a term not exceeding two years, or to both.

New subsection 327.1(3) provides that, in respect of the offences described in subsection 327.1(2), the Attorney General of Canada may proceed by indictment. If convicted, the person is liable to a fine of not less than $50,000 and not more than $1,000,000, or to imprisonment for up to five years, or to both.

New subsection 327.1(4) provides that if a person is convicted of an offence under this section, the person will not be liable to pay a penalty under any of sections 280.1, 280.11 and 283 to 285.1 of the Act for the same action that led to the conviction. This rule will not apply, however, if a notice of assessment in respect of the penalty was issued before the information or complaint giving rise to the conviction was laid or made.

New subsection 327.1(5) provides that the Minister of National Revenue may stay an appeal under Part IX of the Act pending the determination of a prosecution under this section where substantially the same facts are at issue in both instances.

Clause 124

Supplies All or Substantially All for No Consideration

ETA
Sch. V, Pt. VI, section 10

Section 10 of Part VI of Schedule V to the Act exempts supplies by a public sector body of property or services if all or substantially all of the body’s supplies of the property or service are made for no consideration. Such supplies are not considered to be made in the course of a commercial activity. The supply of blood and blood derivatives is excluded from the exemption as these supplies are zero-rated under Part I of Schedule VI to the Act.

Section 10 of Part VI of Schedule V is amended to also expressly exclude from exemption supplies of parking spaces if the supply of a parking space is made for consideration, by way of lease, licence or similar arrangement and in the course of a business carried on by the public sector body.

The amendment clarifies that section 10 of Part VI of Schedule V does not apply to supplies of commercial paid parking by a public sector body even if the body provides a significant amount of parking at no charge.

The amendment is effective December 17, 1990, the date when section 10 was originally enacted.