ft Income Tax Regulations, Legislation and Explanatory Notes

December 1987

Capital Cost Allowance
Certified Productions (Films)
Flow-Through Shares
Resource Sector
R&D Expenditures
Preferred Shares

Canada

Draft Income Tax Regulations, Legislation and Explanatory Notes

December 1987

Capital Cost Allowance
Certified Productions (Films)
Flow-Through Shares
Resource Sector
R&D Expenditures
Preferred Shares

Department of Finance Canada
Ministère des Finances Canada

Draft Income Tax Regulations
Capital Cost Allowance

DRAFT INCOME TAX REGULATIONS

CAPITAL COST ALLOWANCE

The draft amendments to the Income Tax Regulations attached deal with the tax reform proposals relating to capital cost allowance (CCA) announced in the White Paper on June 18, 1987, as well as consequential changes resulting from these proposals. These draft amendments also provide for certain other changes to the CCA system which are consistent with the tax reform proposals and which are described below. Draft amendments to the Regulations relating to the changes proposed in respect of certified productions and certain resource expenditures are dealt with in a separate release.

Major Changes in CCA Rates

The major changes in the CCA rates which are provided for in these draft amendments are summarized below.

	Current CCA Rate	Proposed CCA Rate
Manufacturing machinery and equipment	50% straight line	25% declining balance
Manufacturing retooling half-year	immediate write-off	subject to rule
Resource extraction assets	30% declining balance (plus immediate write-off up to income from new mine)	25% declining balance (plus immediate write-off up to income from new mine)
Drillships and offshore platforms	30% declining balance	25% declining balance
Earth-moving equipment	50% declining balance	30% declining balance
Buildings	5% declining balance	4% declining balance
Satellites	40% declining balance	30% declining balance
Outdoor advertising signs	35% declining balance	20% declining balance
Public utility property	6% declining balance	4% declining balance

Other Changes

The other amendments to the CCA system include the following changes:

- An election is provided to allow a taxpayer to treat individual earth-moving assets and satellites on a separate class basis, as proposed in the White Paper.

- The circumstances in which the prescribed class of a property may be preserved on a transfer of the property are restricted, as proposed in the White Paper, to non-arm's length transfers and to transfers occurring as part of a so-called "butterfly transaction". Similar changes are made to the existing provisions which preserve the exemption of a transferred property from the leasing or rental loss rules following a transfer of such property and from the half-year rule in similar circumstances.

- A new provision is introduced to treat taxpayers as dealing at arm's length with one another in respect of a transaction, for the purposes of the transfer rules described above, where the principal reason for the establishment of a non-arm's length relationship was to make those rules applicable.

- A new rule is introduced to provide that, for the transfer rules described above, where a taxpayer is deemed to have disposed of and to have reacquired a property -- for example, in the case of a corporation in respect of which there has been an acquisition of control -- the taxpayer will be deemed not to deal at arm's length with himself.

- An existing provision allows a taxpayer to defer the recognition of recaptured depreciation in respect of the disposition of a property where he has acquired a similar property at a later date which, because it was acquired at that later date, was included in a different class than the property disposed of. This provision is amended to ensure its availability, in the same circumstances as it is currently available, in respect of assets placed in different classes as a result of the CCA rate changes effected as part of tax reform.

Draft Income Tax Regulations
Capital Cost Allowance

Draft Regulations - Capital Cost Allowance

1.(1) Paragraph 1100(1)(a) of the Income Tax Regulations is amended by deleting the word "and" at the end of subparagraph (xxv) thereof, by adding the word "and" to the end of subparagraph (xxvi) thereof and by adding thereto, immediately after subparagraph (xxvi) thereof, the following subparagraph:

"(xxvii) of Class 41, 25 per cent,"

(2) Subparagraph 1100(1)(w)(i) of the said Regulations is revoked and the following substituted therefor:

"(i) his income for the year from the mine determined before making any deduction under this paragraph, paragraph (x), (y) or (ya), paragraph 20(1)(v.1) of the Act, section 65, 66, 66.1, 66.2 or 66.7 of the Act or section 29 of the Income Tax Application Rules, 1971, and"

(3) Subparagraph 1100(1)(x)(i) of the said Regulations is revoked and the following substituted therefor:

"(i) his income for the year from the mines determined before making any deduction under this paragraph, paragraph (ya), paragraph 20(1)(v.1) of the Act, section 65, 66, 66.1, 66.2 or 66.7 of the Act or section 29 of the Income Tax Application Rules, 1971, and"

(4) Subsection 1100(1) of the said Regulations is further amended by adding thereto, immediately after paragraph (x) thereof, the following heading and paragraphs:

"Additional Allowances - Class 41

(y) such additional amount as he may claim in respect of property described in Class 41 in Schedule II acquired for the purpose of gaining or producing income from a mine or in respect of property acquired for the purpose of gaining or producing income from a mine and for which a separate class is prescribed by subsection 1101(4c), not exceeding the lesser of

(i) his income for the year from the mine determined before making any deduction under this paragraph, paragraph (x) or (ya), paragraph 20(1)(v.1) of the

Act, section 65, 66, 66.1, 66.2 or 66.7 of the Act or section 29 of the Income Tax Application Rules, 1971, and

(ii) the undepreciated capital cost to him of property of that class as of the end of the taxation year (computed without reference to subsection (2) and before making any deduction under this paragraph for the taxation year);

(ya) such additional amount as he may claim in respect of property acquired for the purpose of gaining or producing income from more than one mine and for which a separate class is prescribed by subsection 1101(4d), not exceeding the lesser of

(i) his income for the year from the mines determined before making any deduction under this paragraph, paragraph 20(1)(v.1) of the Act, section 65, 66, 66.1, 66.2 or 66.7 of the Act or section 29 of the Income Tax Application Rules, 1971, and

(ii) the undepreciated capital cost to him of property of that class as of the end of the taxation year (computed without reference to subsection (2) and before making any deduction under this paragraph for the taxation year);"

(5) Subsection 1100(1) of the said Regulations is further amended by adding thereto the following headings and paragraphs:

"Class 38

(aa) such amount as he may claim in respect of property of Class 38 in Schedule II not exceeding that percentage which is the aggregate of

(i) that proportion of 40 per cent that the number of days in the taxation year that are after 1987 and before 1989 is of the number of days in the taxation year that are after 1987,

(ii) that proportion of 35 per cent that the number of days in the taxation year that are after 1988 and before 1990 is of the number of days in the taxation year, and

(iii) that proportion of 30 per cent that the number of days in the taxation year that are after 1989 is of the number of days in the taxation year

of the undepreciated capital cost to him of property of that class as of the end of the taxation year (before making any deduction under this paragraph for the taxation year).

Class 39

(bb) such amount as he may claim in respect of property of Class 39 in Schedule II not exceeding that percentage which is the aggregate of

(i) that proportion of 40 per cent that the number of days in the taxation year that are after 1987 and before 1989 is of the number of days in the taxation year that are after 1987,

(ii) that proportion of 35 per cent that the number of days in the taxation year that are after 1988 and before 1990 is of the number of days in the taxation year,

(iii) that proportion of 30 per cent that the number of days in the taxation year that are after 1989 and before 1991 is of the number of days in the taxation year, and

(iv) that proportion of 25 per cent that the number of days in the taxation year that are after 1990 is of the number of days in the taxation year

of the undepreciated capital cost to him of property of that class as of the end of the taxation year (before making any deduction under this paragraph for the taxation year);

Class 40

(cc) such amount as he may claim in respect of property of Class 40 in Schedule II not exceeding that percentage which is the aggregate of

(i) that proportion of 40 per cent that the number of days in the taxation year that are after 1987 and before 1989 is of the number of days in the taxation year that are after 1987,

(ii) that proportion of 35 per cent that the number of days in the taxation year that are after 1988 and before 1990 is of the number of days in the taxation year, and

(iii) that proportion of 30 per cent that the number of days in the taxation year that are after 1989 and before 1991 is of the number of days in the taxation year

of the undepreciated capital cost to him of property of that class as of the end of the taxation year (before making any deduction under this paragraph for the taxation year);"

(6) All that portion of subsection 1100(2) of the said Regulations following paragraph (a) thereof and preceding paragraph (b) thereof is revoked and the following substituted therefor:

"to the undepreciated capital cost to him of property (other than in respect of property described in paragraph (1)(v) or in any of paragraphs (w) of Class 10 or (a) to (c), (e) to (i), (k), (l), (p) and (q) of Class 12 in Schedule II) of a class in Schedule II (other than any of Classes 13, 14, 15, 23, 24, 27, 29, and 34 therein)

exceeds"

(7) Paragraphs 1100(2.2)(a) to (d) of the said Regulations are revoked and the following substituted therefor:

"(a) in the course of a reorganization in respect of which, if a dividend were received by a corporation in the course of the reorganization, subsection 55(2) of the Act would not be applicable to the dividend by reason of the application of paragraph 55(3)(b) of the Act,"

(8) Section 1100 of the said regulations is amended by adding thereto, immediately after subsection (2.2) thereof, the following subsection:

"(2.21) Where a taxpayer is deemed by a provision of the Act to have disposed of and acquired or reacquired a property,

(a) for the purposes of paragraph (2.2)(e) and subsections 1100(19), 1101(1ad), and 1102(14) and (14.1), the acquisition or reacquisition shall be deemed to have been from a person with whom the taxpayer was not dealing at arm's length at the time of such acquisition or reacquisition, and

(b) for the purposes of paragraphs (2.2)(f) and (g), the taxpayer shall be deemed to be the person from whom the taxpayer acquired or reacquired the property."

(9) Subsection 1100(13) of the said Regulations is revoked and the following substituted therefor:

"(13) For the purposes of subsection (11), where a taxpayer or a partnership has a leasehold interest in a property that is property of Class 1, 3 or 6 in Schedule II by virtue of subsection 1102(5) and the property is leased by the taxpayer or the partnership to a person who owns the land, an interest therein or an option in respect thereof, on which the property is situated, this section shall be read without reference to subsection (12) with respect to that property."

(10) Paragraph 1100(14)(a) of the said Regulations is revoked and the following substituted therefor:

"(a) a building owned by the taxpayer or partnership, whether jointly with another person or otherwise, or"

(11) Paragraph 1100(14)(b) of the said Regulations is revoked and the following substituted therefor:

"(b) a leasehold interest in real property, if the leasehold interest is property of Class 1, 3, 6 or 13 in Schedule II and is owned by the taxpayer or partnership."

(12) Paragraph 1100(17)(b) of the said Regulations is revoked.

(13) Paragraphs 1100(19)(a) to (c) of the said Regulations are revoked and the following substituted therefor:

"(a) in the course of a reorganization in respect of which, if a dividend were received by a corporation in the course of the reorganization, subsection 55(2) of the Act would not be applicable to the dividend by reason of the application of paragraph 55(3)(b) of the Act, or

(b) from a person with whom the taxpayer was not dealing at arm's length (otherwise than by virtue of a right referred to in paragraph 251(5)(b) of the Act) at the time the property was acquired, and"

2.(1) Paragraphs 1101(1ad)(a) to (c) of the said Regulations are revoked and the following substituted therefor:

"(a) in the course of a reorganization in respect of which, if a dividend were received by a corporation in the course of the reorganization, subsection 55(2) of the Act would not be applicable to the dividend by reason of the application of paragraph 55(3)(b) of the Act, or

(b) from a person with whom the taxpayer was not dealing at arm's length (otherwise than by virtue of a right referred to in paragraph 251(5)(b) of the Act) at the time the property was acquired,"

(2) Section 1101 of the said Regulations is amended by adding thereto immediately after subsection (4b) thereof, the following subsections:

"(4c) Where more than one property of a taxpayer is described in paragraph (a) of Class 41 in Schedule II and

(a) one of the properties was acquired for the purpose of gaining or producing income from only one mine, and

(b) one of the properties was acquired for the purpose of gaining or producing income from another mine,

a separate class is hereby prescribed for the properties that

(c) were acquired for the purpose of gaining or producing income from each mine;

(d) would otherwise be included in the class; and

(e) are not included in a separate class by virtue of subsection (4d).

(4d) Where more than one property of a taxpayer is described in paragraph (a) of Class 41 in Schedule II and

(a) one of the properties was acquired for the purpose of gaining or producing income from particular mines, and

(b) one of the properties was acquired for the purpose of gaining or producing income from only one mine or more than one mine other than any of the particular mines,

a separate class is hereby prescribed for the properties that

(c) were acquired for the purpose of gaining or producing income from the particular mines; and

(d) would otherwise be included in the class."

(3) Subsection 1101(5a) of the said Regulations is revoked and the following substituted therefor:

"(5a) For the purposes of this Part, each property of a taxpayer that is an unmanned telecommunication spacecraft described in Class 30 or in paragraph (f.2) of Class 10 in Schedule II is hereby prescribed to be a separate class of property."

(4) Subsection 1101(5j) of the said Regulations is revoked and the following substituted therefor:

"(5j) An election under subsection (5i) or (5k) shall be effective from the first day of the taxation year in respect of which the election is made and shall continue to be effective for all subsequent taxation years.

Class 38 Property and Outdoor Advertising Signs

(5k) A separate class is hereby prescribed for each property of a taxpayer described in Class 38 in Schedule II or in paragraph (l) of Class 8 in Schedule II in respect of which the taxpayer has, by letter attached to the return of his income filed with the Minister in accordance with section 150 of the Act for the taxation year in which the property was acquired, elected that this subsection apply."

3.(1) All that portion of subsection 1102(8) of the said Regulations following paragraph (b) thereof is revoked and the following substituted therefor:

"whichever period is the later, was sold to the customer for the aforesaid purpose, the property shall be included in

(c) Class 10 in Schedule II if it is property acquired

(i) before 1988, or

(ii) before 1990

(A) pursuant to an obligation in writing entered into by the taxpayer before June 18, 1987,

(B) that was under construction by or on behalf of the taxpayer on June 18, 1987, or

(C) that is machinery or equipment that is a fixed and integral part of a building, structure, plant facility or other property that was under construction by or on behalf of the taxpayer on June 18, 1987, or

(d) Class 41 in Schedule II in any other case."

(2) All that portion of subsection 1102(9) of the said Regulations following paragraph (b) thereof is revoked and the following substituted therefor:

"whichever period is the later, the property shall be included in

(c) Class 10 in Schedule II if it is property acquired

(i) before 1988, or

(ii) before 1990

(A) pursuant to an obligation in writing entered into by the taxpayer before June 18, 1987,

(B) that was under construction by or on behalf of the taxpayer on June 18, 1987, or

(C) that is machinery or equipment that is a fixed and integral part of a building, structure, plant facility or other property that was under construction by or on behalf of the taxpayer on June 18, 1987, or

(d) Class 41 in Schedule II in any other case."

(3) Paragraphs 1102(14)(a) to (c) of the said Regulations are revoked and the following substituted therefor:

"(a) in the course of a reorganization in respect of which, if a dividend were received by a corporation in the course of the reorganization, subsection 55(2) of the Act would not be applicable to the dividend by reason of the application of paragraph 55(3)(b) of the Act, or"

(4) Subsection 1102(14) of the said Regulations is further amended by revoking paragraph (d) thereof and substituting the following therefor:

"(b) from a person with whom the taxpayer was not dealing at arm's length (otherwise than by virtue of a right referred to in paragraph 251(5)(b) of the Act) at the time the property was acquired, and"

(5) Paragraph 1102(14)(e) of the said Regulations is revoked.

(6) Subsection 1102(14.1) of the said Regulations is revoked and the following substituted therefor:

"(14.1) For the purposes of this Part and Schedule II, where a taxpayer has acquired, after May 25, 1976, property of a class in Schedule II (in this subsection referred to as the "present class") that had been previously owned before May 26, 1976 by him or by a person with whom he was not dealing at arm's length (otherwise than by virtue of a right referred to in paragraph 251(5)(b) of the Act) at the time the property was acquired, and at the time the property was previously so owned it was a property of a different class in Schedule II (in this subsection referred to as the "former class"), the property shall be deemed to be property of the former class and not property of the present class."

(7) Section 1102 of the said Regulations is further amended by adding thereto the following:

"(20) For the purposes of subsections 1100(2.2) and (19), 1101(1ad) and 1102(14) (in this subsection referred to as the "relevant subsections"), where, but for this subsection, a taxpayer would be considered to be dealing not at arm's length with another person as a result of a transaction or series of transactions the principle purpose of which may reasonably be considered to have been to cause one or more of the relevant subsections to apply in respect of the acquisition of a property, the taxpayer shall be considered to be dealing at arm's length with the other person in respect of the acquisition of that property."

4. Subsection 1103(2d) of the said Regulations is revoked and the following substituted therefor:

"(2d) Where a taxpayer has

(a) disposed of a property (in this subsection referred to as the "former property") of a class in Schedule II (in this subsection referred to as the "former class"), the proceeds of disposition of which exceed the undepreciated capital cost to him of property of the class immediately before the disposition, and

(b) acquired property (in this subsection referred to as the "new property") of a class in Schedule II (in this subsection referred to as the "present class") and the present class is neither

(i) the former class, nor

(ii) a separate class described in section 1101,

such that

(c) if the taxpayer had acquired the former property at the time that he acquired the new property, the former property would have been included in the present class, and

(d) if the taxpayer had acquired the new property at the time that he acquired the former property, the new property would have been included in the former class,

the taxpayer may, by letter attached to the return of his income filed with the Minister in accordance with section 150 of the Act, for the taxation year in which the former property was disposed of, elect to transfer the former property from the former class to the present class in the year of its disposition and for greater certainty the transfer shall be considered to have been made before the disposition of the property.

Transfers from Class 40 to Class 10

(2e) For the purposes of this Part and Schedule II, where property of a taxpayer would otherwise be included in Class 40 in Schedule II, all such properties owned by him shall be transferred from Class 40 to Class 10 immediately after the commencement of the first taxation year of the taxpayer commencing after 1989.

Elections to Include Properties in Class 1, 3 or 6

(2f) In respect of properties otherwise included in Class 20 in Schedule II, a taxpayer may, by letter attached to the return of his income for a taxation year filed with the Minister in accordance with section 150 of the Act, elect to include in Class 1, 3 or 6 in Schedule II, as specified in the letter, all properties of the said Class 20 owned by him at the commencement of the year."

5.(1) All that portion of subsection 1104(5) of the said Regulations preceding paragraph (a) thereof is revoked and the following substituted therefor:

"(5) For the purposes of paragraphs 1100(1)(w) to (ya), subsections 1101(4a) to (4d) and Classes 10, 28 and 41 in Schedule II, "income from a mine", or any expression referring to income from a mine, includes income reasonably attributable to"

(2) All that portion of subsection 1104(7) of the said Regulations preceding paragraph (a) thereof is revoked and the following substituted therefor:

"(7) For the purposes of paragraphs 1100(1)(w) to (ya), subsections 1101(4a) to (4d) and 1102(8) and (9) and Classes 12, 28 and 41 in Schedule II,"

(3) All that portion of subsection 1104(9) of the said Regulations preceding paragraph (a) thereof is revoked and the following substituted therefor:

"(9) For the purposes of Classes 29 and 39 in Schedule II, "manufacturing or processing" does not include"

6.(1) Paragraphs 4600(1)(a) and (b) of the said Regulations are revoked and the following substituted therefor:

"(a) that is included in class 1, 3, 6, 20, 24 or 27 or paragraph (c), (d) or (e) of Class 8 in Schedule II; or

(b) that is included or would, but for Class 28 or Class 41 in Schedule II, be included in paragraph (g) of Class 10 in Schedule II."

(2) Paragraph 4600(2)(a) of the said Regulations is revoked and the following substituted therefor:

"(a) a property included in paragraph (k) of Class 1 or paragraph (a) of Class 2 in Schedule II;"

(3) Paragraph 4600(2)(e) of the said Regulations is revoked and the following substituted therefor:

"(e) a property included in paragraph (a) of Class 10, Class 22, or Class 38, in Schedule II (other than a car or truck designed for use on highways or streets);"

(4) Paragraphs 4600(2)(j) and (k) of the said Regulations are revoked and the following substituted therefor:

"(j) a property included in Class 28 or Class 41 in Schedule II that would, but for that class or classes, as the case may be, be included in paragraph (k) or (r) of Class 10 in schedule II; or

(k) a property included in any of Classes 21, 24, 27, 29, 34, 39 or 40 in Schedule II."

7. Subparagraph 4601(a)(vi) of the said Regulations is revoked and the following substituted therefor:

"(vi) property described in paragraph (m) of Class 10 in Schedule II (other than subparagraph (iv) thereof) that is included in Class 28 or 41 in Schedule II;"

8. Paragraph 4603(a) of the said Regulations is revoked and the following substituted therefor:

"(a) a property included in Class 22 or 38 in Schedule II;"

9.(1) Paragraphs 4604(1)(a) and (b) of the said Regulations are revoked and the following substituted therefor:

"(a) that is included in Class 1, 3, 6, 24, 27 or 37 or paragraph (c), (d) or (e) of Class 8 in Schedule II; or

(b) that is included or would, but for Class 28 or Class 41 in Schedule II, be included in paragraph (g) of Class 10 in Schedule II."

(2) Paragraph 4604(2)(a) of the said Regulations is revoked and the following substituted therefor:

"(a) a property included in paragraph (k) of Class 1 or paragraph (a) of Class 2 in Schedule II;"

(3) Paragraph 4604(2)(d) of the said Regulations is revoked and the following substituted therefor:

"(d) subject to paragraph (e), a property included in paragraph (a) of Class 10, Class 22, or Class 38, in Schedule II (other than a car or truck designed for use on highways or streets);"

(4) Paragraphs 4604(2)(i) and (j) of the said Regulations are revoked and the following substituted therefor:

"(i) a property included in Class 28 or Class 41 in Schedule II that would, but for that class or classes, as the case may be, be included in paragraph (k) or (r) of Class 10 in Schedule II;

(j) a property included in any of Classes 21, 24, 27, 29, 34, 39 or 40 in Schedule II;"

10. Class 1 in Schedule II to the said Regulations is amended by deleting the word "or" at the end of paragraph (i) thereof and by adding thereto the following paragraphs:

"(k) electrical generating equipment;

(l) a pipeline, other than gas or oil well equipment, unless, in the case of a pipeline for oil or natural gas, the Minister in consultation with the Minister of Energy, Mines and Resources, is or has been satisfied that the main source of supply for the pipeline is or was likely to be exhausted within 15 years from the date on which operation of the pipeline commenced;

(m) the generating or distributing equipment and plant (including structures) of a producer or distributor of electrical energy;

(n) manufacturing and distributing equipment and plant (including structures) acquired primarily for the production or distribution of gas, except

(i) a property acquired for the purpose of producing or distributing gas that is normally distributed in portable containers,

(ii) a property acquired for the purpose of processing natural gas, before delivery of such gas to a distribution system, or

(iii) a property acquired for the purpose of producing oxygen or nitrogen;

(o) the distributing equipment and plant (including structures) of a distributor of water;

(p) the production and distributing equipment and plant (including structures) of a distributor of heat; or

(q) a building or other structure, or part thereof, including component parts such as electric wiring, plumbing, sprinkler systems, air-conditioning equipment, lighting fixtures, elevators and escalators;"

11. Class 2 in Schedule II to the said Regulations is amended by adding thereto the following:

"acquired by the taxpayer

(g) before 1988, or

(h) before 1990

(A) pursuant to an obligation in writing entered into by the taxpayer before June 18, 1987,

(B) that was under construction by or on behalf of the taxpayer on June 18, 1987, or

(C) that is machinery or equipment that is a fixed and integral part of a building, structure, plant facility or other property that was under construction by or on behalf of the taxpayer on June 18, 1987."

12.(1) Paragraph (a) of Class 3 in Schedule II to the said Regulations is revoked and the following substituted therefor:

"(a) a building or other structure, or part thereof, including component parts such as electric wiring, plumbing, sprinkler systems, air-conditioning equipment, heating equipment, lighting fixtures, elevators and escalators, acquired by the taxpayer

(i) before 1988, or

(ii) before 1990

(A) pursuant to an obligation in writing entered into by the taxpayer before June 18, 1987,

(B) that was under construction by or on behalf of the taxpayer on June 18, 1987, or

(C) that is a component part of a building that was under construction by or on behalf of the taxpayer on June 18, 1987;"

(2) Paragraph (g) of Class 3 in Schedule II to the said Regulations is revoked and the following substituted therefor:

"(g) an addition or alteration, made during the period that is after March 31, 1967 and before 1988 to a building that would have been included in this class during that period but for the fact that it was included in Class 20;"

(3) Class 3 in Schedule II to the said Regulations is further amended by deleting the word "or" at the end of paragraph (i) thereof, by adding the word "or" at the end of paragraph (j) thereof and by adding thereto the following paragraph:

"(k) an addition or alteration, other than an addition or alteration described in paragraph (k) of Class 6, made after 1987, to a building included, in whole or in part,

(i) in this class,

(ii) in Class 6 by virtue of subparagraph (a)(viii) thereof, or

(iii) Class 20,

to the extent that the aggregate cost of all such additions or alterations to the building does not exceed the lesser of

(iv) $500,000, and

(v) 25% of the aggregate of the amounts that would, but for this paragraph, be the capital cost of the building and any additions or alterations thereto included in this class, Class 6 or Class 20."

13.(1) Paragraph (c) of Class 7 in Schedule II to the said Regulations is revoked and the following substituted therefor:

"(c) a vessel, but not including a vessel

(i) of a separate class prescribed by subsection 1101(2a), or

(ii) included in Class 41;"

(2) Paragraph (g) of Class 7 in Schedule II to the said Regulations is revoked and the following substituted therefor:

"(g) a vessel under construction, other than a vessel included in Class 41."

14. (1) All that portion of Class 8 in Schedule II to the said Regulations preceding paragraph (a) thereof is revoked and the following substituted therefor:

"Property not included in Class 2, 7, 9, 11 or 30 that is"

(2) Class 8 in Schedule II to the said Regulations is further amended by deleting the word "or" at the end of paragraph (j) thereof, by adding the word "or" to the end of paragraph (k) thereof and by adding thereto the following paragraph:

"(l) an outdoor advertising poster panel or bulletin board."

15. Class 10 in Schedule II to the said Regulations is amended by deleting the word "or" at the end of paragraph (f) thereof, by adding the word "or" at the end of paragraph (f.1) thereof and by revoking all that portion thereof following paragraph (f.1) thereof and preceding subparagraph (g)(i) thereof and substituting the following therefor:

"(f.2) an unmanned telecommunication spacecraft designed to orbit above the earth,

and property that would otherwise be included in another class in this Schedule, other than Class 38 or 41, that is

(g) a building or other structure (other than property described in paragraph (l) or (m)) that would otherwise be included in class 1, 3 or 6 and that was acquired for the purpose of gaining or producing income from a mine, except"

16. Paragraph (b) of Class 11 in Schedule II to the said Regulations is revoked and the following substituted therefor:

"(b) an outdoor advertising poster panel or bulletin board acquired by the taxpayer

(i) before 1988, or

(ii) before 1990

(A) pursuant to an obligation in writing entered into by the taxpayer before June 18, 1987, or

(B) that was under construction by or on behalf of the taxpayer on June 18, 1987."

17. Class 22 in Schedule II to the said Regulations is revoked and the following substituted therefor:

"Class 22

Property acquired by the taxpayer after March 16, 1964 and

(a) before 1988, or

(b) before 1990

(i) pursuant to an obligation in writing entered into by the taxpayer before June 18, 1987, or

(ii) that was under construction by or on behalf of the taxpayer on June 18, 1987

that is power-operated movable equipment designed for the purpose of excavating, moving, placing or compacting earth, rock, concrete or asphalt, except a property included in Class 7."

18. Class 28 in Schedule II to the said Regulations is revoked and the following substituted therefor:

"Class 28

Property situated in Canada that would otherwise be included in another class in this Schedule that

(a) was acquired by the taxpayer

(i) before 1988, or

(ii) before 1990

(A) pursuant to an obligation in writing entered into by the taxpayer before June 18, 1987,

(B) that was under construction by or on behalf of the taxpayer on June 18, 1987, or

(C) that is machinery or equipment that is a fixed and integral part of a building, structure, plant facility or other property that was under construction by or on behalf of the taxpayer on June 18, 1987,

and that

(b) was acquired by the taxpayer principally for the purpose of gaining or producing income from one or more mines operated by the taxpayer and situated in Canada and each of which

(i) came into production in reasonable commercial quantities after November 7, 1969, or

(ii) was the subject of a major expansion after November 7, 1969 whereby the greatest designed capacity, measured in tons of input of ore, of the mill that processed the ore from the mine was not less than 25 per cent greater in the year immediately following the expansion than it was in the year immediately preceding the expansion,

(c) was acquired by the taxpayer

(i) after November 7, 1969,

(ii) before the coming into production of the mine or the completion of the expansion of the mine referred to in subparagraph (b)(i) or (ii), as the case may be, and

(iii) in the case of a mine that was the subject of a major expansion described in subparagraph (b)(ii), in the course of and principally for the purposes of the expansion,

(d) had not, before it was acquired by the taxpayer, been used for any purpose whatever by any person with whom the taxpayer was not dealing at arm's length, and

(e) is any of the following

(i) property that was acquired before the mine came into production and that would, but for this class, be included in Class 10 by virtue of paragraph (g), (k), (l) or (r) of the description of that class or would have been so included in that class if it had been acquired after the 1971 taxation year,

(ii) property that was acquired before the mine came into production and that would, but for this class, be included in Class 10 by virtue of paragraph (m) of the description of that class, or

(iii) property that was acquired after the mine came into production and that would, but for this class, be included in Class 10 by virtue of paragraph (g), (k), (l) or (r) of the description of that class,

or that would be described in paragraphs (b), (c), (d) and (e) if

(f) each reference in those paragraphs

(i) to a "mine" were read as a reference to a "mine that is a location in a bituminous sands deposit, oil sands deposit or oil shale deposit from which material is extracted", and

(ii) to "after November 7, 1969" were read as "before November 8, 1969"."

19. Class 29 in Schedule II to the said Regulations is amended by deleting the word "and" at the end of paragraph (a) thereof, by adding the word "and" at the end of paragraph (b) thereof and by adding thereto the following paragraph:

"(c) that is property acquired by the taxpayer

(i) before 1988, or

(ii) before 1990

(A) pursuant to an obligation in writing entered into by the taxpayer before June 18, 1987,

(B) that was under construction by or on behalf of the taxpayer on June 18, 1987, or

(C) that is machinery or equipment that is a fixed and integral part of a building, structure, plant facility or other property that was under construction by or on behalf of the taxpayer on June 18, 1987."

20. Class 30 in Schedule II to the said Regulations is revoked and the following substituted therefor:

"Class 30

Property that is an unmanned telecommunication spacecraft designed to orbit above the earth and acquired by the taxpayer

(a) before 1988, or

(b) before 1990

(A) pursuant to an obligation in writing entered into by the taxpayer before June 18, 1987, or

(B) that was under construction by or on behalf of the taxpayer on June 18, 1987."

21. Class 31 in Schedule II to the said Regulations is amended by deleting the word "and" at the end of paragraph (c) thereof and by adding thereto the following:

"and which was acquired by the taxpayer

(e) before June 18, 1987, or

(f) after June 17, 1987 pursuant to

(i) an obligation in writing entered into by the taxpayer before June 18, 1987, or

(ii) the terms of a prospectus, preliminary prospectus, registration statement, offering memorandum or notice required to be filed with a public authority in Canada and filed before June 18, 1987 with such public authority.

22. All that portion of Class 34 in Schedule II to the said Regulations preceding paragraph (a) thereof is revoked and the following substituted therefor:

"Property that would otherwise be included in Class 1, 2 or 8"

23. Schedule II to the said Regulations is amended by adding thereto the following classes:

"Class 38

Property not included in Class 22 but which would otherwise be included in that class if that class were read without reference to paragraphs (a) and (b) thereof.

Class 39

Property acquired after 1987 that is not included in Class 29, but which would be included in that class if that class were read without reference to subparagraphs (b)(iii) and (v) and paragraph (c) thereof.

Class 40

Property acquired after 1987 and before 1990 that is a powered industrial lift truck or property described in paragraph (b) or (f) of Class 10 and which is property not included in Class 29 but which would otherwise be included in that class if that class were read without reference to paragraph (c) thereof.

Class 41

Property

(a) not included in Class 28 that would otherwise be included in that class if that class were read without reference to paragraph (a) thereof, or

(b) that is property

(i) described in paragraph (f.1), (g), (j), (k), (l), (m), (r), (t), or (u) of Class 10, or

(ii) that is a vessel, including the furniture, fittings, radio communication equipment and other equipment attached thereto, that is designed principally for the purpose of

(A) determining the existence, location, extent or quality of accumulations of petroleum, natural gas or mineral resources, or

(B) drilling oil or gas wells,

and that was acquired by the taxpayer after 1987 other than property that was acquired before 1990

(iii) pursuant to an obligation in writing entered into by the taxpayer before June 18, 1987,

(iv) that was under construction by or on behalf of the taxpayer on June 18, 1987, or

(v) that is machinery and equipment that is a fixed and integral part of property that was under construction by or on behalf of the taxpayer on June 18, 1987."

24.(1) Subsections 1(1) to (5), (9) and (11), subsection 1103(2f) of the said Regulations as enacted by section 4, and section 5 are applicable to the 1988 and subsequent taxation years.

(2) Subsection 1(6) is applicable in respect of property acquired by a taxpayer after 1987 other than property acquired by the taxpayer before 1990

(a) pursuant to an obligation in writing entered into by the taxpayer before June 18, 1987,

(b) that was under construction by or on behalf of the taxpayer on June 18, 1987, or

(c) that is a fixed and integral part of property under construction by or on behalf of the taxpayer on June 18, 1987.

(3) Subsections 1(7) and (13), 2(1), and 3(3) are applicable in respect of property acquired by a taxpayer after June 17, 1987 other than property acquired after that date and before 1990 pursuant to an agreement in writing entered into by the taxpayer before June 18, 1987.

(4) Subsection 1(8) is applicable in respect of respect acquired after November 12, 1981.

(5) Subsections 1(10) and (12) are applicable to the 1994 and subsequent taxation years.

(6) Subsections 2(2) to (4), 3(1) and (2), sections 6 to 11, subsections 12(1) and (3), and sections 13, 14 to 20, 22 and 23 are applicable in respect of property acquired after 1987, except that any election under subsection 1101(5k) of the said Regulations, as enacted by subsection 2(4), made on or before the day that is 180 days after the day on which these Regulations are published in the Canada Gazette shall be deemed to be a valid election made under subsection 1101(5k).

(7) Subsections 3(4), (6) and (7) are applicable in respect of property acquired by a taxpayer after December 15, 1987 other than property acquired after that date and before 1990 pursuant to an obligation in writing entered into by the taxpayer before December 16, 1987.

(8) Subsection 3(5) is applicable in respect of property acquired by a taxpayer after August 31, 1987 other than property acquired after that date and before 1990 pursuant to an obligation in writing entered into by the taxpayer before September 1, 1987.

(9) Subsection 1103(20) of the said Regulations as enacted by section 4 is applicable in respect of dispositions of property occurring after 1987.

(10) Subsection 1103(2e) of the said Regulations as enacted by section 4 is applicable to the 1990 and subsequent taxation years.

(11) Subsection 12(2) is applicable in respect of property acquired after 1978.

(12) Section 21 is applicable in respect of property acquired after June 17, 1987.

Draft Income Tax Regulations Certified Productions (Films)

DRAFT INCOME TAX REGULATIONS

CERTIFIED PRODUCTIONS (FILMS)

The attached draft regulations implement the White Paper capital cost allowance (CCA) proposals with respect to certified film and video tape productions and the details of related transitional relief set out in the August 31, 1987 release by the Minister of Finance, as follows:

- a basic 30% CCA rate, calculated on a declining balance basis, for interests in certified productions acquired after 1987, other than those entitled to transitional relief,

- an additional allowance, in respect of interests in certified productions eligible for the basic 30% CCA rate, equal to the lesser of the undepreciated capital cost of such productions and the income (net of expenses and the basic allowance) from all certified productions in the year, and

- the transitional provisions for the implementation of the tax reform proposals relating to certified productions.

In addition to these measures, the draft regulations provide an exemption from the half-year CCA convention in respect of those certified productions that are governed by the new rules as well as a new exemption from the rules applicable to non-arm's length revenue guarantees where the revenue guarantee is certified to be bona fide and not incorporated in the cost of the film to which it relates. The exemption from the half-year rule is incorporated in the proposed general changes to the Regulations relating to capital cost allowances as set out in a separate release.

Two further measures relating to certified productions are reflected in the Notice of Ways and Means Motion tabled in the House of Commons on December 16, 1987. First, the proposed "put-in-use" rule, when implemented, will not apply to certified productions. Second, and as a transitional measure, any losses created by the deduction in 1988 of CCA in respect of certified productions acquired before 1988 that are eligible for the old rules (the 100% CCA rate) will not be included in the taxpayer's cumulative net investment loss for the purposes of the capital gains exemption.

Draft Income Tax Regulations
Certified Productions

Certified Productions
Draft Regulations

1.(1) Subsection 1100(1) of the Income Tax Regulations is amended by adding thereto, immediately after paragraph (k) thereof, the following heading and paragraph:

"Additional Allowances - Certified Productions

(l) such additional amount as he may claim in respect of property for which a separate class is prescribed by subsection 1101(5l) not exceeding the lesser of

(i) the aggregate of his income for the year from such property, and from property described in paragraph (n) of Class 12 in Schedule II, determined before making any deduction under this paragraph, and

(ii) the undepreciated capital cost to him of property of that separate class as of the end of the year (before making any deduction under this paragraph for the year);"

(2) Paragraph 1100(21)(c) of the said Regulations is repealed and the following substituted therefor:

"(c) where, at any time, a revenue guarantee, other than

(i) a revenue guarantee in respect of which paragraph (b) applies, or

(ii) a revenue guarantee in respect of which the person who agrees to provide the revenue under the terms of the guarantee (in this subsection referred to as the "guarantor") does not deal at arm's length with either the investor or the person from whom the investor acquired the film or tape (in this subsection referred to as the "vendor") and in respect of which the Minister of Communications certifies that

(A) the guarantor is a licenced broadcaster or bona fide film or tape distributor, and

(B) the cost of the film or tape does not include any amount for or in respect of the guarantee,

is entered into in respect of the film or tape, the amount, if any, that may reasonably be considered to be the portion of the revenue that is to be received by the investor under

the terms of the revenue guarantee that has not been included in the investor's income in the particular taxation year or a previous taxation year, if

(iii) the guarantor and the investor are not dealing at arm's length,

(iv) the vendor and the guarantor are not dealing at arm's length, or

(v) the vendor or a person not dealing at arm's length with the vendor undertakes in any way, directly or indirectly, to fulfill all or any part of the guarantor's obligations under the terms of the revenue guarantee; and"

(3) Section 1100 of the said Regulations is amended by adding thereto the following subsection:

"(23) For the purposes of paragraph (21)(a),

(a) the references therein to "60 days" shall be read as references to "182 days" in respect of a film or tape acquired in 1987 other than a film or tape in respect of which paragraph (b) applies; and

(b) the references therein to "60 days after the end of the year" shall be read as references to "366 days after the end of 1987" in respect of a film or tape acquired in 1987 or 1988 that is part of a series of films or tapes that includes a property included in paragraph (n) of Class 12 in Schedule II."

2. Section 1101 of the said Regulations is amended by adding thereto, immediately after subsection (5k) thereof, the following heading and subsection:

"Certified Productions

(5l) A separate class is hereby prescribed for all property of a taxpayer included in Class 10 in Schedule II by reason of paragraph (w) thereof."

3. The definition "certified production" in subsection 1104(2) of the said Regulations is amended by adding thereto, immediately after paragraph (g) thereof, the following:

"and for the purposes of the application of this definition,

(h) the reference in this definition to "60 days" shall be read as a reference to "182 days" in respect of a film or tape acquired in 1987 other a film or tape in respect of which paragraph (i) applies, and

(i) the reference in this definition to "60 days after the end of that year" shall be read as a reference to "366 days after the end of 1987" in respect of a film or tape acquired in 1987 or 1988 that is part of a series of films or tapes that includes a property included in paragraph (n) of Class 12 in Schedule II;"

4.(1) Paragraph (s) of Class 10 of Schedule II to the said Regulations is revoked and the following substituted therefor:

"(s) a motion picture film or video tape acquired after May 25, 1976, except a property included in paragraph (w) or in Class 12;"

(2) Class 10 of Schedule II to the said Regulations is further amended by deleting the word "or" at the end of paragraph (u) thereof, by adding the word "or" at the end of paragraph (v) thereof and by adding thereto the following paragraph:

"(w) a certified production acquired after 1987."

5. Subsections 1(1) and (2) and 4(1) and section 2 are applicable in respect of property acquired after 1987.

6. Subsection 1(3) and section 3 are applicable after 1986.

7. Subsection 4(2) is applicable in respect of property acquired after 1987, other than property

(a) acquired after 1987 pursuant to an agreement in writing entered into by the taxpayer before June 18, 1987 or a prospectus, preliminary prospectus, registration statement or offering memorandum filed before June 18, 1987 with a public authority in Canada where the document was required to be filed before any trade in securities can commence; or

(b) that is a film or tape acquired in 1988 that is part of a series of films or tapes where the series includes films or tapes that are included in Class 12 in Schedule II otherwise than by reason of this paragraph and the film or tape is produced at a fixed price or by reference to a formula under a production option agreement entered into by a licensed broadcaster or bona fide film or tape distributor before 1988.

Draft Income Tax Regulations Prescribed Share for the Purposes of the Provisions Relating to Flow-Through Shares

DRAFT INCOME TAX REGULATIONS

PRESCRIBED SHARE FOR THE PURPOSES OF THE PROVISIONS RELATING TO FLOW-THROUGH SHARES

Section 6202 of the Income Tax Regulations provides for the definition of prescribed share for the purposes of the old flow-through share provisions of the Income Tax Act. These are set out in subparagraphs 66.1(6)(a)(v), 66.2(5)(a)(v) and 66.4(5)(a)(iii) of the Act. This section of the Regulations is amended to apply in respect of the new flow-through share provisions - as provided in paragraph 66(15)(d.1) of the Act. Subject to certain grandfathered agreements and transactions, amended section 6202 does not apply to shares issued on or after June 18, 1987 -- the date on which the new restrictions on shares that qualify for flow-through share treatment were made public.

For shares issued after June 17, 1987 to which section 6202 does not apply, new section 6202.1 provides the definition of prescribed share. Generally, this section provides that a share will be a prescribed share, and therefore not eligible for flow-through share treatment, where the share carries any entitlement to a payment, repayment, loan or dividend or any retraction or conversion right. This includes the right to exchange the share for a share of another corporation that carries any entitlement to a payment, repayment, loan or dividend or any conversion or retraction right (other than a share of a mutual fund corporation that is retractable for fair market value proceeds).

A draft of new section 6202.1 setting out the definition of "prescribed share" was released on June 18, 1987. Since that time, certain minor amendments have been recommended which clarify aspects of the definition and deal with particular concerns that were raised in the consultations following the release. For example, assistance received by a flow-through shareholder under the Canadian Exploration and Development Incentive Program Act will not render the share a prescribed share. These changes are reflected in the draft released today.

Two new provisions are also added to new section 6202.1. The first, in paragraph (2)(a) renders a share a prescribed share where the number of shares to be issued is determined at any time after the agreement to issue the shares is entered into. This change applies with respect to shares issued pursuant to an agreement entered into after December 15, 1987. The second change in paragraph (2)(b) renders a share a prescribed share where the issuing corporation, or a person that does not deal at arm's length with the issuing corporation, provides any form of assistance or benefit for the purposes of assisting any person or partnership in acquiring the share or in acquiring an interest in a partnership

acquiring the share. Subject to certain grandfathered agreements and transactions, this change applies with respect to shares issued after December 15, 1987.

Draft Income Tax Regulations
Flow-Through Shares

DRAFT REGULATIONS - PRESCRIBED SHARES

1.(1) All that portion of section 6202 of the Income Tax Regulations preceding paragraph (a) is revoked and the following substituted therefor:

"6202.(1) For the purposes of paragraph 66(15)(d.1) and subparagraphs 66.1(6)(a)(v), 66.2(5)(a)(v) and 66.4(5)(a)(iii) of the Act, a share of a class of the capital stock of a corporation (in this section referred to as the "issuing corporation") is a prescribed share if it was issued after December 31, 1982, and"

(2) Section 6202 of the said Regulations is further amended by adding thereto the following subsection:

"(2) For the purposes of paragraph 66(15)(d.1) of the Act, subsection (1) does not apply to a share of the capital stock of an issuing corporation that is a new share."

2. Part LXII of the said Regulations is amended by adding thereto, immediately after section 6202 thereof, the following section:

"6202.1(1) For the purposes of paragraph 66(15)(d.1) of the Act, a new share of the capital stock of a corporation is a prescribed share if, at the time it is issued,

(a) under the terms or conditions of the share or any agreement in respect of the share or its issue,

(i) the amount of the dividends that may be declared or paid on the share (in this section referred to as the "dividend entitlement") may reasonably be considered to be, by way of a formula or otherwise,

(A) fixed,

(B) limited to a maximum, or

(C) established to be not less than a minimum (including any amount determined on a cumulative basis) and with respect to the dividend that may be declared or paid on the share there is a preference over any other dividend that may be declared or paid on any other share of the capital stock of corporation,

(ii) the amount that the holder of the share is entitled to receive in respect of the share on the dissolution, liquidation or winding-up of the corporation, on a reduction of the paid-up capital of the share or on the redemption, acquisition or cancellation of the share by the corporation or by specified persons in relation to the corporation (in this section referred to as the "liquidation entitlement") may reasonably be considered to be, by way of a formula or otherwise, fixed, limited to a maximum or established to be not less than a minimum,

(iii) the share is convertible or exchangeable into another security issued by the corporation unless

(A) it is convertible or exchangeable only into

(I) another share of the corporation that, if issued, would not be a prescribed share,

(II) a right or warrant that, if exercised, would allow the person exercising it to acquire a share of the corporation that, if issued, would not be a prescribed share, or

(III) both a share described in subclause (I) and a right or warrant described in subclause (II), and

(B) all the consideration receivable by the holder on the conversion or exchange of the share is the share described in subclause (A)(I) or, the right or warrant described in subclause (A)(II) or both, as the case may be, or

(iv) the corporation has, either absolutely or contingently, an obligation to reduce or any person or partnership has, either absolutely or contingently, an obligation to cause the corporation to reduce the paid-up capital in respect of the share (other than pursuant to a conversion or exchange of the share, where the right to so convert or exchange does not cause the share to be a prescribed share under subparagraph (iii));

(b) any person or partnership has, either absolutely or contingently, an obligation (other than an obligation of the corporation with respect to eligibility for or the amount of

any assistance under the Canadian Exploration and Development Incentive Program Act or with respect to the making of an election respecting such assistance and the flowing out of such assistance to the holder of the share in accordance with section 8 of that Act)

(i) to provide assistance,

(ii) to make a loan or payment,

(iii) to transfer property, or

(iv) otherwise to confer a benefit by any means whatever, including the payment of a dividend,

either immediately or in the future, that may reasonably be considered to be, directly or indirectly, a repayment or return by the corporation or a specified person in relation to the corporation of all or part of the consideration for which the share was issued or for which a partnership interest was issued in a partnership that acquires the share;

(c) any person or partnership has, either absolutely or contingently, an obligation (other than an obligation of the corporation with respect to eligibility for or the amount of any assistance under the Canadian Exploration and Development Incentive Program Act or with respect to the making of an election respecting such assistance and the flowing out of such assistance to the holder of the share in accordance with section 8 of that Act) to effect any undertaking, either immediately or in the future, with respect to the share or the agreement under which the share is issued (including any guarantee, security, indemnity, covenant or agreement and including the lending of funds to or the placing of amounts on deposit with, or on behalf of, the holder of the share and, where the holder is a partnership, the members thereof or specified persons in relation to the holder or the members of the partnership, as the case may be) that may reasonably be considered to have been given to ensure, directly or indirectly, that

(i) any loss that the holder of the share and, where the holder is a partnership, the members thereof or specified persons in relation to the holder or the members of the partnership, as the case may be, may sustain by reason of the holding, ownership or disposition of the share or any other property is limited in any respect, or

(ii) the holder of the share and, where the holder is a partnership, the members thereof or specified persons in relation to the holder or the members of the partnership, as the case may be, will derive earnings by reason of the holding, ownership or disposition of the share or any other property;

(d) the corporation or a specified person in relation to the corporation may reasonably be expected

(i) to acquire or cancel the share in whole or in part otherwise than on a conversion or exchange of the share that meets the conditions set out in clauses (a)(iii)(A) and (B),

(ii) to reduce the paid-up capital of the corporation in respect of the share otherwise than on a conversion or exchange of the share that meets the conditions set out in clauses (a)(iii)(A) and (B), or

(iii) to make a payment, transfer or other provision, (otherwise than pursuant to an obligation of the corporation with respect to eligibility for or the amount of any assistance under the Canadian Exploration and Development Incentive Program Act or with respect to the making of an election respecting such assistance and the flowing out of such assistance to the holder of the share in accordance with section 8 of that Act) directly or indirectly, by way of a dividend, loan, purchase of shares, financial assistance to any purchaser of the share and, where the purchaser is a partnership, the members thereof or in any other manner whatever, that may reasonably be considered to be a repayment or return of all or part of the consideration for which the share was issued or for which a partnership interest was issued in a partnership that acquires the share

within five years after the date the share is issued, otherwise than as a consequence of an amalgamation of a subsidiary wholly-owned corporation, a winding-up of a subsidiary wholly-owned corporation to which subsection 88(1) of the Act applies or the payment of a dividend by a subsidiary wholly-owned corporation to its parent;

(e) any person or partnership can reasonably be expected to effect, within five years after the date the share is issued, any undertaking which if it were in effect at the time the share was issued would result in the share being a prescribed share by reason of paragraph (c); or

(f) it may reasonably be expected that, within five years after the time the share is issued,

(i) any of the terms or conditions of the share or any existing agreement relating to the share or its issue will thereafter be modified, or

(ii) any new agreement relating to the share or its issue will be entered into,

in such a manner that the share would be a prescribed share if it had been issued at the time of such modification or at the time the new agreement is entered into.

(2) For the purposes of paragraph 66(15)(d.1) of the Act, a new share of the capital stock of a corporation is a prescribed share if

(a) the share is issued pursuant to an agreement entered into after December 15, 1987 and the number of shares to be issued by the corporation for the total consideration to be received by the corporation pursuant to the agreement is to be determined by reference to the value of the shares of the corporation on some day after the day the agreement is entered into;

(b) the corporation or a specified person in relation to the corporation, directly or indirectly,

(i) provided assistance,

(ii) made or arranged for a loan or payment,

(iii) transferred property, or

(iv) otherwise conferred a benefit including the payment of a dividend,

for the purpose of assisting any person or partnership in acquiring the share or any person or partnership in acquiring an interest in a partnership acquiring the share; or

(c) the holder of the share or, where the holder is a partnership, a member thereof has a right, under any agreement or arrangement entered into under circumstances where it is reasonable to consider that the agreement or arrangement was contemplated at or before the time that the agreement to issue the share was entered into, to dispose of the share and, through a transaction or event or a series of transactions or events contemplated by the agreement or arrangement, to acquire a share (referred to in this paragraph as the "acquired share") of the capital stock of another corporation that would be a prescribed share under subsection (1), other than a share of a mutual fund corporation, or a corporation that becomes a mutual fund corporation within 90 days of the acquisition of the acquired share, that would not be a prescribed share if subsection (1) were read without reference to subparagraphs (a)(iv) and (d)(i) and (ii) thereof.

(3) For the purposes of subsection (1),

(a) the dividend entitlement of a share of the capital stock of a corporation shall be deemed not to be fixed, limited to a maximum or established to be not less than a minimum where all dividends on the share are determined solely by reference to a multiple or fraction of the dividend entitlement of another share of the capital stock of the corporation, or of another corporation that controls the corporation, where the dividend entitlement of that other share is not described in subparagraph (1)(a)(i); and

(b) the liquidation entitlement of a share of the capital stock of a corporation shall be deemed not to be fixed, limited to a maximum or established to be not less than a minimum where all the liquidation entitlement is determinable solely by reference to the liquidation entitlement of another share of the capital stock of the corporation, or of another corporation that controls the corporation, where the liquidation entitlement of that other share is not described in subparagraph (1)(a)(ii).

(4) For the purposes of paragraphs (1)(c) and (e), an agreement entered into between the first holder of a share and another person or partnership for the sale of the share to that other person or partnership for its fair market value at the time the share is acquired by the other person or partnership (determined without regard to the agreement) shall be deemed not to be an undertaking with respect to the share.

(5) For the purposes of this section and subsection 6202(2),

"new share"
«action nouvelle»

"new share" means a share of the capital stock of a corporation issued on or after June 18, 1987, other than a share issued before 1989

(a) pursuant to an agreement in writing entered into before June 18, 1987,

(b) as part of a distribution of shares of the corporation to the public made in accordance with the terms of a prospectus, preliminary prospectus, registration statement, offering memorandum or notice, required by law to be filed before distribution of the shares could commence, filed before June 18, 1987 with a public authority in Canada pursuant to and in accordance with the securities legislation of the jurisdiction in which the shares were distributed, or

(c) to a partnership where all partnership interests were issued prior to or as part of a distribution to the public made in accordance with the terms of a prospectus, preliminary prospectus, registration statement, offering memorandum or notice, required by law to be filed before any distribution of the interests could commence, filed before June 18, 1987 with a public authority in Canada pursuant to and in accordance with the securities legislation of the jurisdiction in which the interests were distributed;

"specified person"
«personne apparentée»

"specified person" in relation to any particular person means another person with whom the particular person does not deal at arm's length or any partnership or trust of which the particular person or the other person is a member or beneficiary, respectively."

3. Subsection 1(1) is applicable in respect of shares issued after February 1986.

(2) Subsection 1(2) and subsections 6202.1(1), (3), (4) and (5) and paragraph 6202.1(2)(c), as enacted by section 2, are applicable in respect of shares issued after June 17, 1987.

(3) Paragraph 6202.1(2)(a) as enacted by section 2 is applicable in respect of shares issued pursuant to an agreement entered into after December 15, 1987.

(4) Paragraph 6202.1(2)(b) as enacted by section 2 is applicable in respect of shares issued after December 15, 1987, other than shares issued

(a) pursuant to an agreement in writing entered into before December 16, 1987,

(b) as part of a distribution of shares to the public made in accordance with the terms of a prospectus, preliminary prospectus, registration statement, offering memorandum or notice, required by law to be filed before distribution of the shares could commence, filed before December 16, 1987 with a public authority in Canada pursuant to and in accordance with the securities legislation of the jurisdiction in which the shares were distributed, or

(c) to a partnership where all partnership interests were issued prior to or as part of a distribution to the public made in accordance with the terms of a prospectus, preliminary prospectus, registration statement, offering memorandum or notice, required by law to be filed before any distribution of the interests could commence, filed before December 16, 1987 with a public authority in Canada pursuant to and in accordance with the securities legislation of the jurisdiction in which the interests were distributed.

Draft Income Tax Regulations
Resource Sector

DRAFT INCOME TAX REGULATIONS

RESOURCE SECTOR

The attached draft amendments to Income Tax Regulations relating to the resource sector are those necessary to implement the tax reform proposals described below:

- Section 1 of the amendments provides that designated overburden removal costs incurred by a taxpayer after 1987 will not be treated as Class 12 depreciable property. Such costs will be deductible as current operating expenses as proposed in the White Paper on Tax Reform.

- Sections 2 to 4 of the amendments provide for the phase-out of the depletion allowance by the end of 1989. Under the phase-out, depletion allowance will be reduced from 33 1/3 per cent to 16 2/3 per cent with respect to qualifying expenditures incurred after June 30, 1988 and before 1990. No depletion allowance will be available with respect to expenditures incurred after 1989 subject to the 60 day look back period permitted under the Act.

- Section 5 of the amendments provides that the cost of mine shafts and main haulage ways or similar underground work incurred after 1987 will not be treated as Class 12 depreciable property. Such costs will be treated as Canadian development expense as proposed in the White Paper on Tax Reform.

Draft Income Tax Regulations
Resource Sector

DRAFT REGULATIONS - RESOURCE SECTOR

1. Paragraph (a) of the definition "designated overburden removal cost" in subsection 1104(2) of the Income Tax Regulations is revoked and the following substituted therefor:

> "(a) was incurred after November 16, 1978 and before 1988,"

2.(1) All that portion of subparagraph 1203(2)(a)(i) of the said Regulations preceding clause (A) thereof is revoked and the following substituted therefor:

> "(i) the aggregate of all amounts each of which was the stated percentage of an expenditure incurred by him after April 19, 1983 and before the particular time and each of which was a Canadian exploration expense"

(2) Subparagraph 1203(2)(a)(ii) of the said Regulations is revoked and the following substituted therefor:

> "(ii) the aggregate of all amounts each of which is the stated percentage of an amount of assistance or benefit that any person has received, is entitled to receive or, at any time, becomes entitled to receive in respect of an expense described in subparagraph (i), whether such amount is by way of a grant, subsidy, rebate, forgivable loan, deduction from royalty or tax, rebate of royalty or tax, investment allowance or any other form of assistance or benefit, and"

3.(1) All that portion of paragraph 1205(1)(a) of the said Regulations preceding subparagraph (i) thereof is revoked and the following substituted therefor:

> "(a) all amounts, in respect of expenditures (other than expenditures to acquire property under circumstances that entitled him to a deduction under section 1202 or would so entitle him if the amounts referred to in subparagraphs 1202(2)(a)(i) and (ii) or paragraphs 1202(3)(a) and (b), as the case may be, were sufficient for the purpose) incurred by him after November 7, 1969 and before the particular time, each of which was"

(2) All that portion of subparagraph 1205(1)(a)(ii) of the said Regulations preceding clause (A) thereof is revoked and the following substituted therefor:

"(ii) the stated percentage of a Canadian exploration expense other than"

(3) All that portion of subparagraph 1205(1)(a)(iv) of the said Regulations preceding clause (A) thereof is revoked and the following substituted therefor:

"(iv) the stated percentage of the capital cost to him of any processing property acquired by him principally for the purpose of"

(4) All that portion of clause 1205(1)(a)(vi)(B) of the said Regulations preceding subclause (I) thereof is revoked and the following substituted therefor:

"(B) the stated percentage of a Canadian development expense incurred after 1980 in respect of a qualified tertiary oil recovery project of the taxpayer to the extent that such expense is not"

(5) All that portion of clause 1205(1)(a)(vi)(B.1) of the said Regulations preceding subclause (I) thereof is revoked and the following substituted therefor:

"(B.1) the stated percentage of a Canadian exploration expense incurred after 1981 in respect of a qualified tertiary oil recovery project of the taxpayer that"

(6) Clauses 1205(1)(a)(vi)(C) and (D) of the said Regulations are revoked and the following substituted therefor:

"(C) the stated percentage of the capital cost to it of property that is tertiary recovery equipment, and

(D) the stated percentage of the capital cost to it of property that is included in Class 10 in Schedule II by virtue of paragraph (u) of the description of that Class, other than the capital cost to it of property that had, before the property was acquired by it, been used for any purpose whatever by any person with whom it was not dealing at arm's length,"

(7) All that portion of paragraph 1205(1)(b) of the said Regulations preceding subparagraph (i) thereof is revoked and the following substituted therefor:

"(b) all amounts, in respect of expenditures (other than expenditures referred to in paragraph (a) or expenditures to acquire property under circumstances that entitled him to a deduction under section 1202 or would so entitle him if the amounts referred to in subparagraphs 1202(2)(a)(i) and (ii) or paragraphs 1202(3)(a) and (b), as the case may be, were sufficient for the purpose) incurred by him after May 8, 1972 and before the particular time, each of which was the stated percentage of the capital cost to him of property that is included in Class 10 in Schedule II by virtue of paragraph (k) of the description of that Class and that was acquired for the purpose of processing in Canada"

(8) Paragraph 1205(1)(c) of the said Regulations is revoked and the following substituted therefor:

"(c) all amounts, in respect of expenditures (other than expenditures referred to in paragraph (a) or (b) or expenditures to acquire property under circumstances that entitled him to a deduction under section 1202 or would so entitle him if the amounts referred to in subparagraphs 1202(2)(a)(i) and (ii) or paragraphs 1202(3)(a) and (b), as the case may be, were sufficient for the purpose) incurred by him before the particular time, each of which was the stated percentage of the capital cost to him of property (other than the capital cost to him of property that had before the property was acquired by him, been used for any purpose whatever by any person with whom he was not dealing at arm's length) that is included in Class 28 or 41, as the case may be, in Schedule II, other than property

(i) included in Class 28

(A) by virtue of the reference to paragraph (l) in subparagraph (e)(i) thereof, where the property is acquired by the taxpayer before November 17, 1978,

(B) by virtue of subparagraph (e)(ii) thereof,

(C) that is bituminous sands equipment acquired by an individual, or

(D) that is bituminous sands equipment acquired by a corporation before 1981, or

(ii) included in Class 41

(A) that was acquired before the mine came into production and that would, but for Class 41, be included in Class 10 by virtue of paragraph (m) of the description of that class, or

(B) that is bituminous sands equipment acquired by an individual,"

(9) All that portion of paragraph 1205(1)(f) of the said Regulations preceding subparagraph (i) thereof is revoked and the following substituted therefor:

"(f) 33 1/3 per cent of the aggregate of all amounts, each of which is the stated percentage of a cost of borrowing capital, including any cost incurred prior to the commencement of carrying on a business, that was"

(10) All that portion of paragraph 1205(1)(j) of the said Regulations preceding subparagraph (i) thereof is revoked and the following substituted therefor:

"(j) 33 1/3 per cent of the aggregate of all amounts, each of which is the stated percentage of an amount of assistance or benefit in respect of Canadian exploration expenses or Canadian development expenses or that may reasonably be related to Canadian exploration activities or Canadian development activities, whether such amount is by way of a grant, subsidy, rebate, forgivable loan, deduction from royalty or tax, rebate of royalty or tax, investment allowance or any other form of assistance or benefit, that"

4. Subsection 1206(1) of the said Regulations is amended by adding thereto, immediately after the definition "specified percentage" therein, the following definition:

""stated percentage" means

(a) in respect of subparagraph 1203(2)(a)(i) and paragraphs 1205(1)(a) to (f),

(i) 100% in respect of an expense incurred or an amount that became receivable, as the case may be, before July 1, 1988, and

(ii) 50% in respect of an expense incurred or an amount that became receivable, as the case may be, after June 30, 1988 and before 1990, and

(b) in respect of subparagraph 1203(2)(a)(ii) and paragraph 1205(1)(j),

(i) 100% in respect of any assistance or benefit that relates to expenses incurred before July 1, 1988, and

(ii) 50% in respect of any assistance or benefit that relates to expenses incurred after June 30, 1988 and before 1990;"

5. Paragraph (f) of Class 12 of Schedule II to the said Regulations is revoked and the following substituted therefor:

"(f) a mine shaft, main haulage way or similar underground work designed for continuing use, or any extension thereof, sunk or constructed after the mine came into production to the extent that the property was acquired before 1988;"

6. Sections 1 to 5 are applicable to the 1988 and subsequent taxation years.

Draft Legislation and Technical Notes Relating to R&D Expenditures

DRAFT LEGISLATION AND TECHNICAL NOTES RELATING TO R&D EXPENDITURES

The draft legislation attached contains amendments to the provisions in the Income Tax Act relating to deductions and investment tax credits in respect of expenditures on scientific research and experimental development (R&D). The principal changes made in the draft are described below.

- The requirement that R&D expenditures be related to a business of the taxpayer in order to qualify for the R&D incentives is strengthened. Thus, the prosecution of R&D, in and of itself, will not be considered to be a business of the taxpayer to which R&D is related unless the taxpayer derives all or substantially all of his revenue from the prosecution of R&D. In addition, the "related-to-the-business" requirement is extended to payments made to research institutes, universities, and other entities described in new subparagraph 37(1)(a)(ii).

- Any loss for tax purposes which is allocated by a partnership to limited partners and other partners not actively engaged in the partnership business will be denied in the hands of the partner to the extent that the partner's share of the loss is attributable to R&D deductions taken by the partnership. A similar restriction will apply to the R&D investment tax credits allocated by a partnership.

- While the deduction of R&D expenditures will continue to be optional in any year for most taxpayers, partnerships will be required to deduct their R&D expenditures in the year those expenditures are made for the purpose of computing income at the partnership level.

Full details of these changes are set out in the draft legislation and the accompanying explanatory notes. Note that the draft legislation does not include the amendments necessary to implement the proposals in the Notice of Ways and Means Motion tabled in the House of Commons on December 16, 1987 to restrict payments with respect to buildings that will qualify as expenditures on scientific research and experimental development for the purposes of the deduction under section 37 of the Income Tax Act or the investment tax credit under section 127 of that Act. These measures will be merged in the legislation being prepared to implement the tax reform package.

Draft Legislation
Research and Development

Draft Legislation - Research and Development

1.(1) Paragraph 20(1)(t) of the Income Tax Act is repealed.

(2) Subsection (1) is applicable after December 15, 1987.

2.(1) All that portion of subsection 37(1) of the said Act preceding paragraph (c.1) thereof is repealed and the following substituted therefor:

Scientific Research and Experimentation Development

"37.(1) Where a taxpayer carried on a business in Canada in a taxation year and files for the year a prescribed form containing prescribed information, there shall be deducted in computing his income from the business for the year such amount as he may claim not exceeding the amount, if any, by which the aggregate of

(a) the aggregate of all amounts each of which is an expenditure of a current nature made by the taxpayer in the year or in any previous taxation year ending after 1973

(i) on scientific research and experimental development carried on in Canada, related to a business carried on by the taxpayer at the time the expenditure was made, and directly undertaken by or on behalf of the taxpayer, or

(ii) by payments to

(A) an approved association that undertakes scientific research and experimental development,

(B) an approved university, college, research institute or other similar institution,

(C) a corporation resident in Canada and exempt from tax under paragraph 149(1)(j),

(D) a corporation resident in Canada, or

(E) an approved organization that makes payments to an association, institution or corporation described in any of clauses (A) to (C)

to be used for scientific research and experimental development carried on in Canada, related to a business carried on by the taxpayer at the time the payment was made where the taxpayer is entitled to exploit the results of such scientific research and experimental development,

(b) the lesser of

(i) the aggregate of all amounts each of which is an expenditure of a capital nature made by the taxpayer (by acquiring property which would, but for this section, be depreciable property of the taxpayer, other than land or a leasehold interest in land) in the year or in any previous taxation year on scientific research and experimental development carried on in Canada, related to a business carried on by the taxpayer at the time the expenditure was made, and directly undertaken by or on behalf of the taxpayer, and

(ii) the undepreciated capital cost to the taxpayer of the property so acquired as of the end of the taxation year (before making any deduction under this paragraph in computing the income of the taxpayer for the taxation year),

(c) the aggregate of all amounts each of which is an expenditure made by the taxpayer in the year or in any previous taxation year ending after 1973 by way of repayment of amounts paid to the taxpayer under an Appropriation Act and on terms and conditions approved by the Treasury Board in respect of scientific research and experimental development expenditures made for the purpose of advancing or sustaining the technological capability of Canadian manufacturing or other industry, and"

(2) Paragraph 37(1)(h) of the said Act is repealed and the following substituted therefor:

"(h) where the taxpayer is a corporation control of which has been acquired by a person or group of persons before the end of the year, the amount determined for the year under subsection (6.1) with respect to the corporation."

(3) Subsection 37(2) of the said Act is repealed and the following substituted therefor:

Research Outside Canada

"(2) In computing the income of a taxpayer for a taxation year from a business carried on by him, there may be deducted expenditures of a current nature made by him in the year

(a) on scientific research and experimental development carried on outside Canada related to the business and directly undertaken by or on behalf of the taxpayer; or

(b) by payments to an approved association, university, college, research institute or other similar institution to be used for scientific research and experimental development carried on outside Canada related to the business where the taxpayer is entitled to exploit the results of such scientific research and experimental development."

(4) Subsection 37(6) of the said Act is repealed and the following substituted therefor:

Expenditures of a Capital Nature

"(6) An amount claimed under subsection (1) that may reasonably be considered to be in respect of a property described in paragraph (1)(b) shall, for the purpose of section 13, be deemed to be an amount allowed to the taxpayer in respect of the property acquired by the expenditures under regulations made under paragraph 20(1)(a), and for that purpose the property acquired by the expenditures shall be deemed to be of a separate prescribed class."

(5) That portion of subsection 37(6.1) of the said Act preceding subparagraph (a)(ii) thereof is repealed and the following substituted therefor:

Amount referred to in paragraph (1)(h)

"(6.1) Where a taxpayer is a corporation control of which was last acquired by a person or group of persons at any time (in this subsection referred to as "that time") before the end of a taxation year of the corporation, the amount determined for the purposes of paragraph (1)(h) for the year with respect to the corporation is the amount, if any, by which

(a) the amount, if any, by which

(i) the aggregate of all amounts each of which is

(A) an expenditure described in paragraph (1)(a) or (c) that was made by the corporation before that time,

(B) the lesser of the amounts determined in respect of the corporation under subparagraphs (1)(b)(i) and (ii) immediately before that time, or

(C) an amount determined in respect of the corporation under paragraph (1)(c.1) for its taxation year ending immediately before that time

exceeds the aggregate of all amounts each of which is"

(6) All that portion of subparagraph 37(6.1)(b)(i) of the said Act preceding clause (A) thereof is repealed and the following substituted therefor:

"(i) where the business to which the amounts described in clauses (a)(i)(A), (B) or (C) may reasonably be considered to have been related was carried on by the corporation for profit or with a reasonable expectation of profit throughout the year, the aggregate of"

(7) Subsection 37(7) of the said Act is further amended by striking out the word "and" at the end of paragraph (c) thereof, by repealing paragraph (d) thereof, and by substituting the following therefor:

"(d) for greater certainty, references to scientific research and experimental development related to a business include any scientific research and experimental development that may lead to or facilitate an extension of that business; and"

(8) Subsection 37(7) of the said Act is further amended by adding thereto the following paragraph:

"(e) except in the case of a taxpayer that derives all or substantially all of his revenue from the prosecution of scientific research and experimental development (including the sale of rights arising out of scientific research and experimental development carried on by him), the prosecution of scientific research and experimental development shall not be considered to be a business of the taxpayer to which an expenditure is related."

(9) Subsection (1) is applicable after December 15, 1987 except that, with respect to expenditures made before December 16, 1987, or after December 15, 1987 and before 1989 pursuant to

> (a) an obligation in writing entered into before December 16, 1987, or
>
> (b) the terms of a prospectus, preliminary prospectus or registration statement filed before December 16, 1987 with a public authority in Canada pursuant to and in accordance with the securities legislation of any province

where the expenditure is made by way of a payment made to an entity described in subparagraph 37(1)(a)(ii) as enacted by subsection (1), the scientific research and experimental development to be performed pursuant to that payment is so performed before 1989, subsection 37(1) of the said Act shall be read without reference to subsection (1).

(10) Subsections (2), (4), (5), (6) and (7) are applicable after December 15, 1987.

(11) Subsections (3) and (8) are applicable with respect to expenditures made after December 15, 1987 other than expenditures made after that date and before 1989 pursuant to an obligation in writing entered into before December 16, 1987 or the terms of a prospectus, preliminary prospectus or registration statement filed before December 16, 1987 with a public authority in Canada pursuant to and in accordance with the securities legislation of any province.

3.(1) Subsection 96(1) of the said Act is amended by adding thereto, immediately after paragraph (e) thereof, the following paragraph:

> "(e.1) each income or loss of the partnership were computed as if that portion of subsection 37(1) preceding paragraph (a) thereof were read without reference to the words "such amount as he may claim not exceeding";"

(2) Paragraph 96(1)(g) of the said Act is repealed and the following substituted therefor:

> "(g) the amount, if any, by which
>
> (i) the loss of the partnership for a taxation year from any source or sources in a particular place,
>
> exceeds

(ii) in the case of a specified member of the partnership in the year, the amount, if any, deducted by the partnership by virtue of section 37 in calculating its income for the taxation year from that source or sources in the particular place, as the case may be, and

(iii) in any other case, nil

were the loss of the taxpayer from that source or from sources in that particular place, as the case may be, for the taxation year of the taxpayer in which the partnership's taxation year ends, to the extent of the taxpayer's share thereof."

(3) Paragraph 96(2.1)(a) of the said Act is repealed and the following substituted therefor:

"(a) the aggregate of all amounts each of which is his share of the amount of any loss of the partnership, determined in accordance with subsection 96(1), for a fiscal period of the partnership ending in the taxation year from a business (other than a farming business) or from property"

(4) Subsections (1) and (2) are applicable for taxation years of partnerships ending after December 15, 1987 except that, where a taxpayer acquired a partnership interest before December 16, 1987, or after December 15, 1987

(a) pursuant to an obligation in writing entered into before December 16, 1987, or

(b) and before February 1, 1988 pursuant to the terms of a prospectus, preliminary prospectus, or registration statement filed before December 16, 1987 with a public authority in Canada pursuant to and in accordance with the securities legislation of any province,

subsections (1) and (2) shall not apply in respect of the taxpayer to expenditures made by the partnership

(c) before December 16, 1987, or

(d) after December 15, 1987 and before 1989 pursuant to

(i) an obligation in writing entered into by the partnership before December 16, 1987, or

(ii) the terms of a prospectus, preliminary prospectus, or registration statement filed before December 16, 1987 with a public authority in Canada pursuant to and in accordance with the securities legislation of any province.

(5) Subsection (3) is applicable after December 15, 1987.

4.(1) Subsection 127(8) of the said Act is repealed and the following substituted therefor:

Investment tax credit of partnership

"(8) Where, in a particular taxation year of a taxpayer who is a member of a partnership, an amount would, if the partnership were a person and its fiscal period were its taxation year, be determined in respect of the partnership, <u>for its taxation year ending in that particular taxation year</u>, under paragraph (a), (b) or (e.1) of the definition "investment tax credit" in subsection (9), if

(a) paragraph (a) of that definition were read without reference to subparagraph (iii) thereof, <u>and</u>

(b) <u>in the case of a taxpayer who is a specified member of the partnership in the taxation year of the partnership, paragraph (a) of that definition were read without reference to subparagraph (ii) thereof</u>,

the portion of that amount that may reasonably be considered to be the taxpayer's share thereof shall be added in computing the investment tax credit of the taxpayer at the end of that particular taxation year."

(2) Subsection (1) is applicable in respect of expenditures made after December 15, 1987 except that, where a taxpayer acquired a partnership interest

(a) before December 16, 1987, or

(b) after December 15, 1987

(i) pursuant to an obligation in writing entered into before December 16, 1987, or

(ii) and before February 1, 1988 pursuant to the terms of a prospectus, preliminary prospectus, or registration statement filed before December 16, 1987

with a public authority in Canada pursuant to and in accordance with the securities legislation of any province,

subsection (1) shall not apply in respect of the taxpayer to expenditures made by the partnership before December 16, 1987, or after December 15, 1987 and before 1989 pursuant to

(c) an obligation in writing entered into by the partnership before December 16, 1987, or

(d) the terms of a prospectus, preliminary prospectus or registration statement filed before December 16, 1987 with a public authority in Canada pursuant to and in accordance with the securities legislation of any province.

5.(1) Subsection 248(1) of the said Act is amended by adding thereto, in alphabetical order within the subsection, the following definition:

"specified member"

"associé déterminé"

""specified member" of a partnership in a taxation year of the partnership means

(a) any member of the partnership who was a limited partner (within the meaning assigned by subsection 96(2.4)) of the partnership at any time in the year, and

(b) any member of the partnership, other than a member who was

(i) actively engaged in those activities of the partnership business which were other than the financing of the partnership business, or

(ii) carrying on a similar business as that carried on by the partnership in its taxation year, otherwise than as a member of a partnership,

on a regular, continuous and substantial basis throughout the year;"

(2) Subsection (1) is applicable after December 15, 1987.

6.(1) For the purposes of sections 2 to 4, a person or partnership shall be considered not to be obliged to make an expenditure or to acquire an interest in a partnership if the person

or partnership may be excused from performing the obligation as a result of changes to the said Act affecting expenditures in respect of scientific research and experimental development.

Explanatory Notes to Research and Development Expenditures

EXPLANATORY NOTES TO PROPOSED INCOME TAX AMENDMENTS RELATING TO EXPENDITURES IN RESPECT OF SCIENTIFIC RESEARCH AND EXPERIMENTAL DEVELOPMENT

Clause 1

Deductions

ITA
20(1)(t)

Section 20 of the Act sets out a number of specific deductions that are allowed in computing income from a business or property. Paragraph 20(1)(t) permits a taxpayer to deduct in computing his income for a taxation year such amounts in respect of scientific research and experimental development as are permitted by sections 37 or 37.1. This paragraph is redundant and could cause confusion with respect to the changes to section 37 and subsection 96(1) described below. As a consequence, paragraph 20(1)(t) is repealed effective after December 15, 1987.

Clause 2

Scientific Research and Experimental Development

Subclause 2(1)

ITA
37(1)

Under subsection 37(1) of the Act, expenditures in respect of scientific research and experimental development (R&D) made by a taxpayer for R&D carried on in Canada are accumulated in a pool. The balance of the pool at the end of any year may either be deducted in that year or carried forward to be deducted in subsequent years. However, such expenditures are only deductible in a year if the taxpayer carries on business in Canada in the year.

The amendments to paragraphs 37(1)(a) to (c) of the Act refine the requirement that, in order to qualify for the purposes of a deduction under section 37, an R&D expenditure must be related to a business of the taxpayer carried on at the time that the expenditure was made. In addition, the amendments extend the related-to-the-business requirement for payments made to research institutes, universities and other entities described in new subparagraph 37(1)(a)(ii). The changes to subsection 37(1) also provide that a taxpayer who has made R&D expenditures in a year in respect of a particular business, but

not claimed a deduction in the year, may deduct those expenditures in any subsequent year in computing his income from that or any other business carried on by him in the subsequent year. Paragraph 37(1)(b) has also been clarified to ensure that it applies only in respect of property that would otherwise be depreciable property and to exclude a leasehold interest in land.

These amendments are applicable with respect to expenditures made after December 15, 1987 other than such expenditures made before 1989 pursuant to an obligation in writing entered into before December 16, 1987 or a prospectus, preliminary prospectus or registration statement filed with a public authority before December 16, 1987. However, if an expenditure is made by way of a payment to a third party listed in new subparagraph 37(1)(a)(ii) and pursuant to such a written obligation or prospectus, preliminary prospectus or registration statement, the R&D to be performed as a result of such payment must be performed before 1989 in order for the expenditure to be eligible for this transitional relief.

Subclause 2(2)

ITA
37(1)(h)

Paragraph 37(1)(h) and subsection 37(6.1) of the Act restrict a corporation's ability to carry forward its pool of unused R&D deductions where there has been a change of its control. In general terms, the undeducted portion of R&D expenditures made before control of a corporation is acquired may be carried forward to be deducted in computing its income for a subsequent taxation year only where the business to which the expenditure related is carried on by the corporation for profit or with a reasonable expectation of profit, and only to the extent of its income for the year (before making any deduction under subsection 37(1)) from that or a similar business. The amendment to paragraph 37(1)(h) is strictly consequential on the change to subsection 37(1) which allows a taxpayer a deduction in computing income for a taxation year in respect of a particular business in respect of any R&D expenditures related to any business of the taxpayer. This amendment is applicable after December 15, 1987.

Subclause 2(3)

ITA
37(2)

Subsection 37(2) of the Act allows a taxpayer to deduct expenditures of a current nature made in respect of R&D carried on outside Canada. The amendment to this subsection is consequential on the

changes to subsection 37(1) to incorporate the refinements made to the "related-to-the-business" test and to include the requirement that payments to third parties who conduct R&D on behalf of the taxpayer will qualify for deduction only if the taxpayer is entitled to exploit the results of the R&D. These changes are applicable with respect to expenditures made after December 15, 1987, other than such expenditures made before 1989 pursuant to an obligation in writing entered into before December 16, 1987 or a prospectus, preliminary prospectus or registration statement filed with a public authority before December 16, 1987.

Subclause 2(4)

ITA
37(6)

Subsection 37(6) of the Act treats an amount claimed under subsection 37(1) in respect of property as an amount deducted as capital cost allowance in respect of the property for the purposes of calculating any recaptured depreciation or terminal loss that may arise when the property is disposed. This subsection is amended as a consequence of the restructuring of subsection 37(1) which amends the opening words of the preamble to subsection 37(1) and of each of paragraphs 37(1)(a), (b) and (c) so that subsection 37(1) operates as a pool of all expenditures described in each of those paragraphs, rather than as a separate pool for each paragraph. This amendment is applicable after December 15, 1987.

Subclauses 2(5) and (6)

ITA
37(6.1)

Paragraph 37(1)(h) and subsection 37(6.1) taken together restrict a corporation's ability to carry forward its pool of unused R&D deductions where there has been a change of its control. In general terms, the undeducted portion of R&D expenditures made before control of a corporation is acquired may be carried forward to be deducted in computing its income for a subsequent taxation year only where the business to which the expenditures related is carried on by the corporation for profit or with a reasonable expectation of profit, and only to the extent of its income for the year (before making any deduction under subsection 37(1)) from that or a similar business. The amendment to subsection 37(6.1) is strictly consequential on the change to subsection 37(1) which allows a taxpayer a deduction in computing income for a taxation year in respect of a particular business in respect of any R&D expenditures related to any business of the taxpayer. This amendment is applicable after December 15, 1987.

Subclause 2(7)

ITA
37(7)(d)

Paragraph 37(7)(d) of the Act provides that, for the purposes of section 37, R&D which may lead to or facilitate an extension of a business will be considered to be related to that business. This paragraph is amended simply to conform the terminology used therein with that used in subsection 37(1) as amended. This amendment is applicable after December 15, 1987.

Subclause 2(8)

ITA
37(7)(e)

New paragraph 37(7)(e) of the Act clarifies that, for the purposes of the "related-to-the-business" test that is a precondition for the deduction of R&D expenditures, unless a taxpayer derives all or substantially all of his revenue from the prosecution of R&D, the prosecution of R&D will not itself be considered to be a business to which an R&D expenditure is related. This change is particularly relevant for taxpayers who are members of partnerships. New subsection 37(7)(e) is applicable in respect of expenditures made after December 15, 1987 except expenditures made after that date, and before 1989, pursuant to an agreement in writing entered into before December 16, 1987 or to the terms of a prospectus, preliminary prospectus or registration statement filed with a public authority before December 16, 1987.

Subclauses 2(9) to (11)

These set out the effective dates to the amendments to section 37 relating to the deduction in respect of R&D expenditures.

Clause 3

Partnerships

Subclauses 3(1) and (2)

ITA
96(1)(e.1) and (g)

Under subsection 96(1) of the Act, the income earned and losses incurred by a partnership are generally calculated at the partnership level but attributed to partners in accordance with their respective interests.

New paragraph 96(1)(e.1) is added to require a partnership to deduct in calculating its income for a fiscal period all R&D expenditures made by it in the period. This change is consequential on the general scheme of the deduction with respect to R&D expenditures which requires that, to be deductible, they must be related to a business carried on by the taxpayer at the time they are made. Thus, partnerships will no longer be able to incur R&D expenditures in one year for carry-forward to a subsequent year when the partners may have changed.

Paragraph 96(1)(g) is amended to provide that, in calculating the share of "specified members" of a partnership of any loss incurred by the partnership for a fiscal period of the partnership, the loss of the partnership, in respect of that partner, will be reduced by an amount equal to the amount deducted by the partnership by virtue of section 37 in calculating its income for the period. The expression "specified member" is defined in subsection 248(1) of the Act and includes any member of a partnership who is a limited partner or who is neither actively engaged in the activities of the partnership nor otherwise engaged in a similar business to that carried by the partnership.

These amendments are applicable to fiscal periods of partnerships ending after December 15, 1987 except that they do not apply in respect of partners who acquired their partnership interest before December 16, 1987 or after December 15, 1987

> (a) pursuant to an obligation in writing entered into before December 16, 1987, or
>
> (b) and before February 1, 1988 pursuant to the terms of a prospectus, preliminary prospectus or registration statement filed with a public authority before December 16, 1987

to the extent that the expenditures were made before December 16, 1987 or after December 15, 1987 and before 1989 pursuant to a written obligation entered into before December 16, 1987, or the terms of a prospectus, preliminary prospectus of registration statement filed with a public authority before December 16, 1987.

Subclause 3(3)

ITA
96(2.1)(a)

Subsection 96(2.1) of the Act deals with the losses of limited partnerships. The amendment to paragraph 96(2.1)(a) is consequential on the amendment to subsection 96(1) and ensures that the losses of a limited partnership are determined having regard to

the restrictions in that subsection on the deduction of R&D expenditures made by a partnership. This amendment is effective after December 15, 1987.

Subclauses 3(4) and (5)

These set out the effective dates for the amendments to section 96 dealing with partnerships.

Clause 4

Investment Tax Credit

ITA
127(8)

Subsection 127(8) of the Act provides for the allocation of the investment tax credit (ITC) of a partnership to its partners. This subsection is amended to exclude from this allocation to a "specified member" of a partnership any ITC earned in respect of R&D expenditures made by the partnership. The expression "specified member" is defined in subsection 248(1) of the Act and includes any member of a partnership who is a limited partner or who is neither actively engaged in the partnership activities nor otherwise engaged in a similar business to that carried on by the partnership.

This amendment is applicable with respect to expenditures made after December 15, 1987 except that, in respect of a member of a partnership who acquired his partnership interest before December 16, 1987 or after December 15, 1987

> (a) pursuant to an obligation in writing entered into before December 16, 1987, or
>
> (b) and before February 1, 1988 pursuant to the terms of a prospectus, preliminary prospectus or registration statement filed with a public authority before December 16, 1987,

it is not applicable in respect of expenditures made before December 16, 1987 or after December 15, 1987 and before 1989 pursuant to a written obligation entered into before December 16, 1987 or pursuant to a prospectus, preliminary prospectus of registration statement filed with a public authority before December 16, 1987.

Clause 5

Definitions

ITA
248(1)

The definition "specified member" of a partnership is added to subsection 248(1) of the Act, applicable after December 15, 1987. Generally, a "specified member" of a partnership in a taxation year is

> (a) a member who was a limited partner of the partnership at any time in the taxation year of the partnership, or
>
> (b) a member who was neither actively engaged in the business of the partnership throughout the partnership's taxation year nor, throughout the partnership's taxation year, otherwise engaged in a similar business as that carried on by the partnership.

This definition is used in new subsection 96(1) relating to partnership losses and subsection 127(8) relating to partnership investment tax credits.

Clause 6

Interpretation of Coming-into-force Provisions

Clause 6 provides a rule of interpretation for the coming-into-force provisions for Clauses 2 to 4. Those coming-into-force provisions provide what is generally referred to as "grandfather treatment" for certain expenditures in respect of R&D made or partnership interests acquired after December 15, 1987 pursuant to agreements in writing entered into on or before that date. The rule in this clause provides that for the purpose of those coming-into-force provisions, where a party may be excused from an obligation to make an expenditure or acquisition as a result of changes to the Act affecting the expenditure or acquisition, the person shall be considered not to have been obliged to make the expenditure or acquisition. In that case, the expenditure or acquisition will not be grandfathered.

Draft Legislation and Regulations, and Explanatory Notes Relating to Preferred Shares

PREFERRED SHARES

Background

The proposed rules for the taxation of dividends paid on preferred shares introduced in the form of draft legislation on June 18, 1987 were designed to eliminate the benefits from the use of preferred shares as a form of after-tax financing. By raising funds through the issue of preferred shares rather than debt, non-taxpaying corporations were able to transfer at least a part of the tax benefit of accumulated losses, deductions and tax credits to the holders of the preferred shares, because of the special tax treatment given dividends under the Canadian tax system. The volume of preferred share issues has increased significantly in recent years as unused deductions, losses and credits have grown. The level of such financing in Canada is much greater than in other jurisdictions because of the special tax treatment of dividends in the hands of shareholders -- both individual and corporate. The use of preferred shares as a method of after tax financing has resulted in a significant loss of tax revenues to government.

The draft amendments proposed on June 18, 1987 provided for special taxes to be levied on dividends paid on certain preferred shares issued after that date. These rules, which are summarized briefly here, were described in detail in the June 18, 1987 release. Under those amendments an issuing corporation would be able to choose between two forms of tax, one that imposed a 25% tax on dividends paid on taxable preferred shares with an additional 10% tax on certain corporate recipients of the dividend and one that levied a 40% tax on dividends paid with no additional tax on a corporate shareholder. An offset against corporate taxes otherwise payable for either the 25% or the 40% tax was achieved by allowing the issuing corporation to claim a deduction for 5/2 of the tax payable. For taxpaying corporations any tax payable on dividends paid on taxable preferred shares was offset by a reduction in its corporate income taxes currently payable. For non-taxpaying corporations the deduction for 5/2 of the dividend tax in a year increased the non-capital loss available to reduce corporate taxes in the preceding three or subsequent seven years.

Mechanisms were provided within the new system to ensure that the new taxes on preferred share dividends would not affect financial arrangements between smaller corporations and their shareholders and also would not inhibit the financing of new ventures by such corporations. Taxes on dividends paid on taxable preferred shares were payable only if annual dividends on such shares exceeded $500,000 for a corporation or any associated group of corporations. This exemption was reduced dollar for dollar by dividends on taxable preferred shares in excess of $1 million paid in the previous calendar

year. In addition, the system accommodated dividends paid within a corporate group by providing an exemption from the proposed taxes for dividends paid to a shareholder with a substantial interest in the payer corporation. For this purpose, a shareholder had a substantial interest in a corporation if the shareholder was related to the corporation or owned together with related persons at least 25% of the "votes and value" of the corporation.

Additional taxation of certain categories of preferred shares was also provided for in the June 18, 1987 draft legislation. As a result of a growing tendency for corporations to raise short-term financing by way of preferred shares, dividends on shares retractable within five years from the date of issue were denied the inter-corporate dividend deduction. Dividends received by a specified financial institution (SFI) on term preferred shares (shares that are retractable or that may be required to be redeemed) issued before June 18, 1987 also were denied the inter-corporate dividend deduction. Dividends paid on preferred shares other than term preferred shares (taxable SFI shares) issued before June 18, 1987 and acquired after that time were subject to a special 10% tax if received by an SFI. Exceptions were provided to both the term preferred share and taxable SFI share rules for dividends on shares listed on a prescribed stock exchange.

Comments on the proposed rules relating to preferred shares have been received from a number of individuals and corporations as well as from various industry associations. A number of technical issues were raised such as the application of the grandfathering rules to transactions in progress, the application of the rules where shares are issued in various corporate reorganizations and estate planning transactions and to technical aspects of the definitions of the various categories of preferred shares.

The amendments proposed on June 18, 1987 have been thoroughly reviewed in the light of the representations received. While several relieving changes of substance have been made and many technical improvements have been introduced, the regime as originally proposed remains largely intact.

Short-Term Preferred Shares

The treatment of dividends on short-term preferred shares as originally proposed could create unintended difficulties. Relief from the disallowance of the inter-corporate dividend deduction with respect to such dividends applied only for dividends between related corporations. Because the $500,000 threshold did not apply to dividends on such shares, the rules relating to short-term preferred shares applied inappropriately in a number of circumstances. In addition, the definition of short-term preferred share applied to a

number of shares issued primarily to accommodate certain reorganizations and estate planning transactions thus denying the inter-corporate dividend deduction for deemed dividends arising on the redemption of such shares. Several changes to the proposals have been made in this regard.

Under the revised rules, dividends on short-term preferred shares will not be denied the inter-corporate dividend deduction. Instead, the dividend-paying corporation will be required to pay a tax on such dividends under Part VI.1 at a rate of 66 2/3%. The deduction in computing taxable income for 5/2 of taxes paid under Part VI.1 of the Act will apply to this new tax. In addition, the $500,000 dividend allowance and the exemption for dividends paid to shareholders with a substantial interest in the dividend paying corporation will apply. As a result, most transactions between smaller corporations and their shareholders will no longer be affected by the rules on short-term preferred shares.

Corporate Reorganizations

In the June 18, 1987 proposals, deemed dividends arising during the course of so-called "butterfly reorganizations" were exempted from the preferred share taxes. The revised draft legislation provides an exemption from Part VI.1 taxes for deemed dividends arising on the redemption or acquisition of preferred shares in most corporate reorganizations or transactions to restructure the share capital of corporations. Such transactions are unrelated to after-tax financing.

Term Preferred Shares issued after December 15, 1987

The change in the treatment of short-term preferred shares requires a consequential change to the treatment of dividends received by specified financial institutions (SFIs) on term preferred shares issued after December 15, 1987. There was some concern that a number of corporations would issue preferred shares to financial institutions up to a level sufficient for the $500,000 dividend allowance to fully shelter all dividends from the taxes payable under Part VI.1. Under the revised system the definition of term preferred shares will not be restricted to shares issued before June 18, 1987 and any dividends received by an SFI on term preferred shares issued after December 15, 1987 will be denied the inter-corporate dividend deduction. Shares issued after December 15, 1987 and listed on a prescribed stock exchange will be excluded from the definition of term preferred share provided the number of shares held by an SFI and persons related to it does not exceed 10% of the issued and outstanding shares of the class. These rules thus parallel the rules in effect for SFIs before June 18, 1987.

Preferred Shares issued before June 18, 1987

(a) Term Preferred Shares

The exclusion from term preferred shares under the existing system for a publicly listed class of preferred shares applies where no more than 10% of the class is held by an SFI and persons related to it. The June 18, 1987 amendments would have reduced the limit to 5% for shares acquired in 1988 and 2% for shares acquired after 1988.

In the revised draft legislation the exclusion will vary depending upon whether a corporate holder of a term preferred share is a "restricted financial institution" (RFI). An RFI is defined as a financial institution (a bank, an insurance corporation, a credit union, a trust company or a loan company) and corporations controlled by any such financial institution. With respect to shares issued before June 18, 1987, the exclusion from term preferred shares issued before June 18, 1987 for a publicly listed class of shares is to be made more restrictive for RFIs but less restrictive for all other SFIs. The definition of an SFI is extremely broad. It would include all companies within a related group if any company in that group is a financial institution -- such as a loan corporation, captive insurance corporation or any corporation regardless of size that is a financial institution. The revised rules will permit broader holdings of these shares by corporations other than the financial institutions themselves to avoid undue influence on the market for these shares.

The exclusion from the term preferred share rules with respect to a publicly listed class of preferred shares in the revised proposals will apply to an SFI, with respect to shares acquired before December 16, 1987, where no more than 10% of the class is held by the SFI and persons related to it. However, no exclusion will be available with respect to term preferred shares issued before June 18, 1987 and acquired after December 15, 1987 by an RFI. The exclusion for these shares acquired after December 15, 1987 with respect to an SFI other than an RFI will continue to apply where no more than 10% of the class is held by that SFI and persons related to it (rather than the phase down to a 2% test previously proposed).

(b) Taxable RFI Shares

Taxable RFI shares have relevance only for restricted financial institutions. A 10% tax was applied in the June 18, 1987 version of the draft legislation to dividends on holdings of taxable SFI shares -- generally preferred shares issued before June 18, 1987 other than term preferred shares -- received by SFIs beyond prescribed holding limits. Under the revised draft legislation, this

tax, levied under Part IV.1 of the Act, will apply only to dividends received by RFIs and the affected shares will be renamed taxable RFI shares.

An exclusion from the definition of taxable RFI shares for a class of publicly listed shares is provided with respect to shares acquired by an RFI before December 16, 1987, where no more than 10% of the class is held by the RFI and any other RFI related to it. However, no exclusion will apply for taxable RFI shares acquired by an RFI after December 15, 1987.

Grandfathered Shares

The grandfathering provisions have been extended to provide grandfathered status for most shares acquired on the conversion of instruments existing before June 18, 1987 and on the exercise of warrants issued before that date.

$500,000 Dividend Allowance

The $500,000 dividend allowance reflected in the June 18, 1987 draft legislation to accommodate small corporations would have allowed a significant use of preferred shares as a substitute for debt. Several changes are made to address this problem in the revised draft legislation. The application of the term preferred share rules to retractable shares issued after December 15, 1987 and held by SFIs will prevent corporations from arranging preferred share financings with financial institutions to take advantage of the dividend allowance. In addition, the revised amendments change the rules that would have reduced the $500,000 dividend allowance dividends on taxable preferred shares in the preceding calendar year in excess of $1,000,000. The dividend allowance will now be reduced dollar for dollar by the amount of dividends on taxable preferred shares as well as shares that would be taxable preferred shares had they been issued after June 18, 1987. This change will effectively eliminate the dividend allowance for most large corporations.

Provincial Sharing

Taxes levied under Part VI.1 and Part IV.1 will be shared with the provinces and the enabling legislation with respect thereto will be introduced together with the amendments to the Income Tax Act on preferred shares. The sharing of these taxes with the provinces is appropriate as the proposed legislation contemplates the provinces providing a deduction in computing taxable income for purposes of provincial corporate taxation for 5/2 of Part VI.1 tax payable.

Draft Legislation
Preferred Shares

DRAFT LEGISLATION
PREFERRED SHARES

1.(1) Subsection 82(2) of the Income Tax Act is repealed and the following substituted therefor:

Dividends received

"(2) Where, by reason of subsection 56(4) or sections 74 to 75, there is included in computing a taxpayer's income for a taxation year a dividend received by another person, for the purposes of this Act, the dividend shall be deemed to have been received by the taxpayer."

(2) Subsection (1) is applicable to dividends received after June 18, 1987.

2.(1) Section 84 of the said Act is amended by adding thereto, immediately after subsection (4.1) thereof, the following subsections:

Deemed dividend on term preferred share

- "(4.2) Where at any time after November 16, 1978 the paid-up capital in respect of a term preferred share owned by a shareholder that is

(a) a specified financial institution, or

(b) a partnership or trust of which a specified financial institution or a person related thereto was a member or a beneficiary,

was reduced otherwise than by way of a redemption, acquisition or cancellation of the share or of a transaction described in subsection (2) or (4.1), the amount received by the shareholder on the reduction of the paid-up capital in respect of the share shall be deemed to be a dividend received by the shareholder at that time unless the share was not acquired in the ordinary course of the business carried on by the shareholder.

Deemed dividend on taxable preferred shares

(4.3) Where at any time after 1987 the paid-up capital in respect of a taxable preferred share of the capital stock of a corporation was reduced otherwise than by way of a redemption, acquisition or cancellation of the share or of a transaction

described in subsection (2) or (4.1), the amount paid on the reduction of the paid-up capital in respect of the share shall be deemed to be a dividend on the share

(a) for the purposes of Part VI.1, paid at that time by the corporation; and

(b) for the purposes of this Act, received at that time by the person to whom the amount was paid.

Deemed dividend on taxable RFI shares

(4.4) Where at any time after 1987 the paid-up capital in respect of a taxable RFI share owned by a shareholder that is

(a) a restricted financial institution, or

(b) a partnership or trust of which a restricted financial institution was a member or a beneficiary

was reduced otherwise than by way of a redemption, acquisition or cancellation of the share or of a transaction described in subsection (2) or (4.1), the amount received by the shareholder on the reduction of the paid-up capital in respect of the share shall be deemed to be a dividend received by the shareholder at that time." -

(2) Subsection (1) is applicable with respect to reductions of paid-up capital after 1987.

3.(1) Subsection 87(2) of the said Act is amended by striking out the word "and" at the end of paragraph (pp) thereof and by adding thereto the following paragraphs:

Tax on taxable preferred shares

- "(rr) for the purposes of subsection 112(2.9), paragraph 191(4)(c) and subsections 191.1(2) and (4), the new corporation shall be deemed to be the same corporation as, and a continuation of, each predecessor corporation, and

Transferred liability for Part VI.1 tax

(ss) for the purposes of section 191.3, the new corporation shall be deemed to be the same corporation as, and a continuation of, each predecessor corporation." -

(2) Section 87 of the said Act is further amended by adding thereto, immediately after subsection (4.1) thereof, the following subsection:

Idem

- "(4.2) Where there has been an amalgamation or merger of two or more corporations after November 27, 1986 and a share of any class of the capital stock of the new corporation (in this subsection referred to as the "new share") was issued to a shareholder in consideration for the disposition of a share by that shareholder of any class of the capital stock of a predecessor corporation (in this subsection referred to as the "exchanged share") and the terms and conditions of the new share were the same as, or substantially the same as, the terms and conditions of the exchanged share, for the purposes of applying the provisions of this subsection, subsections 112(2.2) and (2.4), Parts IV.I and VI.I, section 258 and the definitions "grandfathered share", "short-term preferred share", "taxable preferred share" and "taxable RFI share" in subsection 248(1) to the new share, the following rules apply :

(a) the new share shall be deemed to have been issued at the time the exchanged share was issued;

(b) where the exchanged share was a share described in paragraph (a), (b), (c) or (d) of the definition "grandfathered share" in subsection 248(1), the new share shall be deemed to be the same share as the exchanged share for the purposes of that definition;

(c) the new share shall be deemed to have been acquired by the shareholder at the time the exchanged share was acquired by the shareholder;

(d) the new corporation shall be deemed to be the same corporation as, and a continuation of, each predecessor corporation; and

(e) an election made under subsection 191.2(1) by a predecessor corporation with respect to the class of shares of its capital stock to which the exchanged share belonged shall be deemed to be an election made by the new corporation with respect to the class of shares of its capital stock to which the new share belongs." -

(3) Subsection (1) is applicable to amalgamations occurring after June 18, 1987.

(4) Subsection (2) is applicable to amalgamations and mergers occurring after November 27, 1986.

4.(1) All that portion of paragraph 88(1)(e.2) of the said Act preceding subparagraph (i) thereof is repealed and the following substituted therefor:

> "(e.2) paragraphs 87(2)(c), (d.1), (e.1), (g) to (l), (l.3) to (u), (x), (y.1), (z.1), (cc), (ll) to (nn), (pp) and (rr), subsection 87(6) and, subject to section 78, subsection 87(7) apply to the winding-up as if the references therein to"

(2) All that portion of paragraph 88(1.1)(e) of the said Act preceding subparagraph (i) thereof is repealed and the following substituted therefor:

> "(e) where, at any time, control of the parent or subsidiary has been acquired by a person or group of persons, no amount in respect of the subsidiary's non-capital loss or farm loss for a taxation year ending before that time is deductible in computing the taxable income of the parent for a particular taxation year ending after that time, except that such portion of the subsidiary's non-capital loss or farm loss as may reasonably be regarded as its loss from carrying on a business and, where a business was carried on by the subsidiary in that year, such portion of the non-capital loss as may reasonably be regarded as being in respect of an amount deductible under paragraph 110(1)(k) in computing its taxable income for the year is deductible"

(3) Subsection (1) is applicable to windings-up ending after June 18, 1987.

(4) Subsection (2) is applicable with respect to non-capital losses and farm losses for the 1988 and subsequent taxation years.

5.(1) Subsection 110(1) of the said Act is amended by striking out the word "and" at the end of paragraph (i) thereof, by adding the word "and" at the end of paragraph (j) thereof and by adding thereto the following paragraph:

Part VI.1 tax

- "(k) 5/2 of the tax payable under subsection 191.1(1) by the taxpayer for the year." -

(2) Subsection (1) is applicable to the 1988 and subsequent taxation years except that in the application of paragraph 110(1)(k) of the said Act, as enacted by subsection (1), to taxation years

ending before July, 1988 the reference therein to "5/2 of" shall be read as a reference to "2 times".

6.(1) All that portion of paragraph 111(5)(a) of the said Act preceding subparagraph (i) thereof is repealed and the following substituted therefor:

> "(a) such portion of the corporation's non-capital loss or farm loss, as the case may be, for a taxation year ending before that time as may reasonably be regarded as its loss from carrying on a business and, where a business was carried on by the corporation in that year, such portion of the non-capital loss as may reasonably be regarded as being in respect of an amount deductible under paragraph 110(1)(k) in computing its taxable income for the year is deductible by the corporation for a particular taxation year ending after that time"

(2) All that portion of paragraph 111(5)(b) of the said Act preceding subparagraph (i) thereof is repealed and the following substituted therefor:

> "(b) such portion of the corporation's non-capital loss or farm loss, as the case may be, for a taxation year ending after that time as may reasonably be regarded as its loss from carrying on a business and, where a business was carried on by the corporation in that year, such portion of the non-capital loss as may reasonably be regarded as being in respect of an amount deductible under paragraph 110(1)(k) in computing its taxable income for the year is deductible by the corporation for a particular year ending before that time"

(3) Clause 111(8)(b)(i)(A) of the said Act is repealed and the following substituted therefor:

> "(A) the aggregate of all amounts each of which is the taxpayer's loss for the year from an office, employment, business or property, his allowable business investment loss for the year or an amount deductible under paragraph 110(1)(d), (d.1), (d.2), (d.3), (f), (j) or (k), section 110.6 or 112 or subsection 113(1) or 138(6) in computing his taxable income for the year"

(4) Subsections (1) and (2) are applicable with respect to non-capital losses and farm losses for the 1988 and subsequent taxation years.

(5) Subsection (3) is applicable with respect to the 1988 and subsequent taxation years except that

(a) for the purpose of computing a corporation's taxable income for a taxation year ending before July, 1988 the amount of the corporation's non-capital loss for another taxation year ending after June, 1988 shall be deemed to be the amount, if any, by which

(i) the amount that would, but for this paragraph, be the non-capital loss for the other year,

exceeds

(ii) 1/5 of the lesser of

(A) the amount deductible under paragraph 110(1)(k) of the said Act, as enacted by subsection 5(1), in computing the corporation's taxable income for the other year, and

(B) the amount that would, but for this paragraph, be the non-capital loss for the other year;

(b) for the purpose of computing a corporation's taxable income for a taxation year ending after June, 1988 the amount of the corporation's non-capital loss for another taxation year ending before July, 1988 shall be deemed to be the aggregate of

(i) the amount that would, but for this paragraph be the non-capital loss for the other year, and

(ii) 1/4 of the lesser of

(A) the amount deductible under paragraph 110(1)(k) of the said Act, as enacted by subsection 5(1), in computing the corporation's taxable income for the other year, and

(B) the amount that would, but for this paragraph, be the non-capital loss for the other year; and

(c) for the purpose of subsection 111(3) of the said Act the aggregate of all amounts each of which is an amount deducted in computing a corporation's taxable income or an amount claimed under Part IV of the said Act for a taxation

year ending before July, 1988 in respect of a non-capital loss for another taxation year ending after June, 1988 shall be deemed to be the aggregate of

(i) all amounts so deducted or so claimed, and

(ii) 1/4 of the amount, if any, by which

(A) all the amounts so deducted or so claimed

exceeds

(B) the amount, if any, by which the amount deductible for the year in respect of the non-capital loss exceeds 4/5 of the amount deductible under paragraph 110(1)(k) of the said Act, as enacted by subsection 5(1), in computing the corporation's taxable income for the other year.

7.(1) Subsections 112(2.1) and (2.2) of the said Act are repealed and the following substituted therefor:

Where no deduction permitted

"(2.1) No deduction may be made under subsection (1) or (2) in computing the taxable income of a specified financial institution in respect of a dividend received by it on a share that was, at the time the dividend was paid, a term preferred share, other than a dividend paid on a share of the capital stock of a corporation that was not acquired in the ordinary course of the business carried on by the institution, and for the purposes of this subsection, where a restricted financial institution received the dividend on a share of the capital stock of a mutual fund corporation or an investment corporation at any time after it has elected pursuant to subsection 131(10) not to be a restricted financial institution, the share shall be deemed to be a term preferred share acquired in the ordinary course of business.

Idem

(2.2) No deduction may be made under subsection (1), (2) or 138(6) in computing the taxable income of a particular corporation in respect of a dividend received on a share of the capital stock of a corporation that was issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 where a person or partnership (other than the issuer of the share or an individual other than a trust) that is a specified financial

institution or a specified person in relation to any such institution was, at or immediately before the time the dividend was paid, obligated, either absolutely or contingently and either immediately or in the future, to effect any undertaking (in this subsection referred to as a "guarantee agreement"), including any guarantee, covenant or agreement to purchase or repurchase the share and including the lending of funds to or the placing of amounts on deposit with, or on behalf of, the particular corporation or any specified person in relation to the particular corporation, given to ensure that

(a) any loss that the particular corporation or a specified person in relation to the particular corporation may sustain by reason of the ownership, holding or disposition of the share or any other property is limited in any respect, or

(b) the particular corporation or a specified person in relation to the particular corporation will derive earnings by reason of the ownership, holding or disposition of the share or any other property,

and the guarantee agreement was given as part of a transaction or event or a series of transactions or events that included the issuance or acquisition of the share, except that this subsection does not apply to a dividend received on

(c) a share that was at the time the dividend was received a share described in paragraph (e) of the definition "term preferred share" in subsection 248(1) during the applicable time period referred to in that paragraph,

(d) a grandfathered share, a taxable preferred share issued before December 16, 1987 or a prescribed share,

(e) a taxable preferred share issued after December 15, 1987 and of a class of the capital stock of a corporation that is listed on a prescribed stock exchange where all guarantee agreements in respect of the share were given by the issuer of the share, by one or more persons that would be related to the issuer if this Act were read without reference to paragraph 251(5)(b) or by the issuer and one or more such persons unless at the time the dividend is received the shareholder or the shareholder and specified persons in relation to the shareholder receive dividends in respect of more than 10 per cent of the issued and outstanding shares to which the guarantee agreement applies;

and for the purposes of this subsection

(f) where a guarantee agreement in respect of a share is given at any particular time after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, otherwise than pursuant to a written arrangement to do so entered into before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, the share shall be deemed to have been issued at the particular time and the guarantee agreement shall be deemed to have been given as part of a series of transactions that included the issuance or acquisition of the share; and

(g) "specified person" has the meaning assigned by paragraph (h) of the definition "taxable preferred share" in subsection 248(1)." -

(2) Subsection 112(2.3) of the said Act is repealed.

(3) Subsection 112(2.9) of the said Act is repealed and the following substituted therefor:

Related corporations

"(2.9) For the purposes of subparagraph (2.4)(b)(i), where it may reasonably be considered having regard to all the circumstances that a corporation has become related to any other corporation for the purpose of avoiding any limitation upon the deduction of a dividend under subsection (1), (2) or 138(6), the corporation shall be deemed not to be related to the other corporation."

(4) Subsection 112(2.1) of the said Act, as enacted by subsection (1), is applicable with respect to dividends received after June 18, 1987.

(5) Subsection 112(2.2) of the said Act, as enacted by subsection (1), is applicable with respect to dividends received on shares (other than grandfathered shares) issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 and on shares deemed by subsection 112(2.2) of the said Act, as enacted by subsection (1), to have been issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987.

(6) Subsection (2) is applicable with respect to dividends received on short-term preferred shares (other than grandfathered shares) issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987.

(7) Subsection (3) is applicable after 5.00 p.m. Eastern Standard Time, November 27, 1986.

8.(1) Section 131 of the said Act is amended by adding thereto the following subsection:

Restricted Financial Institution

"(10) Notwithstanding any other provision of this Act a mutual fund corporation or an investment corporation that at any time would, but for this subsection, be a restricted financial institution shall, if it has so elected in prescribed manner and prescribed form before that time, be deemed not to be a restricted financial institution."

(2) Subsection 131(10) of the said Act, as enacted by subsection (1), is applicable after December 15, 1987 except that the prescribed form referred to therein may be filed at any time on or before the day that is 6 months after the day on which this Act is assented to.

9.(1) Subsection 138(6) of the said Act is repealed and the following substituted therefor:

Deduction for dividends from taxable corporations

"(6) In computing the taxable income of a life insurer for a taxation year, no deduction from the income of the insurer for the year may be made under section 112 but, except as otherwise provided by that section, there may be deducted from such income the aggregate of taxable dividends (other than dividends on term preferred shares that are acquired in the ordinary course of the business carried on by the life insurer) included in computing the insurer's income for the year and received by the insurer in the year from taxable Canadian corporations."

(2) Subsection (1) is applicable with respect to dividends received after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987.

10.(1) Subparagraph 157(1)(a)(i) of the said Act is repealed and the following substituted therefor:

"(i) on or before the last day of each month in the year, the aggregate of an amount equal to 1/12 of the amount estimated by it to be the tax payable under this Part by it for the year computed without reference to

sections 127.2 and 127.3 and an amount equal to 1/12 of the amount estimated by it to be the tax payable under Part VI.1 by it for the year,"

(2) All that portion of paragraph 157(1)(b) of the said Act preceding subparagraph (i) thereof is repealed and the following substituted therefor:

"(b) the remainder of the taxes payable by it under this Part and Part VI.1 for the year".

(3) All that portion of subsection 157(2) of the said Act following paragraph (b) thereof is repealed and the following substituted therefor:

"and for the year or the immediately preceding taxation year

(c) its taxable income was not more than $10,000, and

(d) no tax was payable by it under Part VI.1,

it may, instead of paying the instalments required by subsection (1), pay to the Receiver General at the end of the third month following the end of the year the aggregate of the taxes payable by it under this Part and Part VI.1 for the year."

(4) Subsection 157(2.1) of the said Act is repealed and the following substituted therefor:

Idem

"(2.1) Where

(a) the aggregate of the tax payable under this Part (computed without reference to sections 127.2 and 127.3) and the tax payable under Part VI.1 by a corporation for a taxation year, or

(b) the corporation's first instalment base for the year

is not more than $1,000, the corporation may, instead of paying the instalments required by paragraph (1)(a) for the year, pay to the Receiver General, pursuant to paragraph (1)(b), the aggregate of the taxes payable by it under this Part and Part VI.1 for the year."

(5) Subsections (1) to (4) are applicable to the 1988 and subsequent taxation years.

11.(1) Subsection 161(3) of the said Act is repealed and the following substituted therefor:

Special case

"(3) In addition to the interest payable under subsection (1), where a corporation that paid tax for a taxation year under subsection 157(2) had a taxable income for the year of more than $10,000 or had a tax payable for the year under Part VI.1, it shall, forthwith after assessment, pay an amount equal to 3% of the aggregate of the taxes payable by it under this Part and Part VI.1 for the year."

(2) Paragraph 161(4.1)(a) of the said Act is repealed and the following substituted therefor:

"(a) the aggregate of the tax payable under this Part by it for the year computed without reference to sections 127.2 and 127.3 and the tax payable under Part VI.1 by it for the year,"

(3) Subsection (1) is applicable to the 1988 and subsequent taxation years.

(4) Subsection (2) is applicable to the 1988 and subsequent taxation years, except that for the purposes of computing interest on instalments payable for a corporation's 1988 taxation year that commenced in 1987,

(a) the tax for the year payable under Part VI.1 of the said Act by the corporation shall, for the purpose of paragraph 161(4.1)(a) of the said Act, as enacted by subsection (1), be deemed to be nil; and

(b) the tax for the year payable under Part I of the said Act by the corporation shall, for the purpose of paragraph 161(4.1)(a) of the said Act, as enacted by subsection (1), be determined as if the said Act were read without reference to paragraph 110(1)(k) thereof as enacted by subsection 5(1).

12.(1) All that portion of paragraph 186(1)(b) of the said Act preceding subparagraph (i) thereof is repealed and the following substituted therefor:

"(b) all amounts, each of which is an amount in respect of a taxable dividend, in respect of which an amount is deductible under subsection 112(1) from its income for the year, received by the particular corporation in the year

from a corporation (in this section referred to as the "payer corporation") connected with the particular corporation equal to that proportion of"

(2) Section 186 of the said Act is further amended by adding thereto, immediately after subsection (1) thereof, the following subsection:

Reduction in tax

- "(1.1) Notwithstanding subsection (1), where a taxable dividend referred to in paragraph (1)(a) or (b) was received by a corporation in a taxation year and was included in an amount in respect of which tax under Part IV.1 was payable by the corporation for the year, the tax otherwise payable under this Part by the corporation for the year shall be reduced

(a) where the dividend is a taxable dividend referred to in paragraph (1)(a), by 10% of the amount determined in respect of that dividend under that paragraph; and

(b) where the dividend is a taxable dividend referred to in paragraph (1)(b), by 10% of the amount determined in respect of that dividend for the purpose of the computation under that paragraph." -

(3) Section 186 of the said Act is further amended by adding thereto the following subsection:

Partnerships

- "(6) For the purposes of this Part,

(a) all amounts received in a fiscal period by a partnership as, on account or in lieu of payment of, or in satisfaction of, taxable dividends shall be deemed to have been received by each member of the partnership in the member's fiscal period or taxation year in which the partnership's fiscal period ends, to the extent of that member's share thereof; and

(b) each member of a partnership shall be deemed to own at any time that proportion of the number of the shares of each class of the capital stock of a corporation that are property of the partnership at that time that the member's share of all dividends received on such shares by the partnership in its fiscal period that includes that time is of the total of all such dividends." -

(4) Subsections (1) and (2) are applicable to dividends received after June 18, 1987.

(5) Subsection (3) is applicable with respect to fiscal periods ending after June 18, 1987.

13.(1) The said Act is amended by adding thereto, immediately after section 187 thereof, the following Part:

- "PART IV.1

TAXES ON DIVIDENDS ON CERTAIN PREFERRED SHARES RECEIVED BY CORPORATIONS.

Definitions

187.1 In this Part, "excepted dividend" means a dividend

(a) received by a corporation on a share of the capital stock of a foreign affiliate of the corporation where the share was not acquired by the corporation in the ordinary course of the business carried on by the corporation,

(b) received by a corporation from another corporation in which it has or would have, if the other corporation were a taxable Canadian corporation, a substantial interest (as determined under section 191) at the time the dividend was paid, or

(c) received by a corporation that was, at the time the dividend was received, a private corporation or a financial intermediary corporation (within the meaning assigned by subsection 191(1)).

Tax on dividends on taxable preferred shares

187.2 Every corporation shall, on or before the last day of the second month after the end of each taxation year, pay a tax under this Part for the year equal to 10% of the aggregate of all amounts each of which is a dividend, other than an excepted dividend, received by the corporation in the year on a taxable preferred share (other than a short-term preferred share or a share of a class in respect of which an election under subsection 191.2(1) has been made) to the extent that an amount in respect of the dividend was deductible under section 112 or 113 or subsection 138(6) in computing its taxable income for the year or under subsection 115(1) in computing its taxable income earned in Canada for the year.

Tax on dividends on taxable RFI shares

187.3(1) Every restricted financial institution shall, on or before the last day of the second month after the end of each taxation year, pay a tax under this Part for the year equal to 10% of the aggregate of all amounts each of which is a dividend, other than an excepted dividend, received by the institution at any time in the year on a share acquired by any person before that time and after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 that was, at the time the dividend was paid, a taxable RFI share to the extent that an amount in respect of the dividend was deductible under section 112 or 113 or subsection 138(6) in computing its taxable income for the year or under subsection 115(1) in computing its taxable income earned in Canada for the year.

Time of acquisition of share

(2) For the purposes of subsection (1),

(a) a share of the capital stock of a corporation acquired by a person after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 pursuant to an agreement in writing entered into before that time shall be deemed to have been acquired by that person before that time;

(b) a share of the capital stock of a corporation acquired by a person after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 and before 1988 as part of a distribution to the public made in accordance with the terms of a prospectus, preliminary prospectus, registration statement, offering memorandum or notice filed before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 with a public authority pursuant to and in accordance with the securities legislation of the jurisdiction in which the shares are distributed shall be deemed to have been acquired by that person before that time;

(c) a share (in this paragraph referred to as the "new share") of the capital stock of a corporation that is acquired by a person after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 in exchange for

(i) a share of a corporation which was issued before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 or is a grandfathered share, or

(ii) a debt obligation of a corporation which was issued before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, or issued after that time pursuant to an agreement in writing entered into before that time

where the right to the exchange for the new share and all or substantially all the terms and conditions of the new share were established in writing before that time shall be deemed to have been acquired by that person before that time;

(d) a share of the capital stock of a Canadian corporation listed on a prescribed stock exchange in Canada that is acquired by a person after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 upon the exercise of a right

(i) that was issued before that time and listed on a prescribed stock exchange in Canada, and

(ii) the terms of which at that time included the right to acquire the share,

where all or substantially all the terms and conditions of the share were established in writing before that time shall be deemed to have been acquired by that person before that time; and

(e) where a share that was owned by a particular restricted financial institution at 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 has, by one or more transactions between related restricted financial institutions, been transferred to another restricted financial institution, the share shall be deemed to have been acquired by the other restricted financial institution before that time unless at any particular time after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 and before the share was transferred to the other restricted financial institution the share was owned by a shareholder who, at that particular time, was a person other than a restricted financial institution related to the particular restricted financial institution.

Partnerships

187.4 For the purposes of this Part,

(a) all amounts received in a fiscal period by a partnership as, on account or in lieu of payment of, or in satisfaction of, dividends shall be deemed to have been received by each member of the partnership in the member's fiscal period or taxation year in which the partnership's fiscal period ends, to the extent of that member's share thereof;

(b) each member of a partnership shall be deemed to own at any time that proportion of the number of the shares of each class of the capital stock of a corporation that are property of the partnership at that time that the member's share of all dividends received on such shares by the partnership in its fiscal period that includes that time is of the total of all such dividends; and

(c) a reference to a person includes a partnership.

Information return

187.5 Every corporation liable to pay tax under this Part for a taxation year shall file with the Minister, not later than the day on or before which it is required by section 150 to file its return of income for the year under Part I, a return for the year under this Part in prescribed form containing an estimate of the taxes payable by it under sections 187.2 and 187.3 for the year.

Provisions applicable to Part

187.6 Sections 152, 158 and 159, subsections 161(1), (2) and (11), sections 162 to 167 and Division J of Part I are applicable to this Part with such modifications as the circumstances require." -

(2) Subsection (1) is applicable with respect to dividends received after 1987 and for this purpose where a dividend is received at any time after December 15, 1987 and before 1988 on a share, and it may reasonably be considered, having regard to all the circumstances including the amount of any dividends that may be paid or declared on the share after 1987, that the dividend was paid at that time to avoid or limit the application of Part IV.1 of the said Act, as enacted by subsection (1), the dividend shall be deemed for the purposes of that Part to have been received on January 1, 1988 and the reference in section 187.2 and subsection 187.3(1) to "in computing its taxable income for the year or under subsection 115(1) in computing its taxable income earned in Canada for the year" shall be read as a reference to "in computing its taxable income or under subsection 115(1) in computing its taxable income earned in Canada".

14.(1) The said Act is further amended by adding thereto, immediately after section 190.24 thereof, the following Part:

- "PART VI.I

TAX ON CORPORATION PAYING DIVIDENDS ON TAXABLE PREFERRED SHARES

Definitions

191.(1) In this Part,

"excluded dividend"

"excluded dividend" means a dividend

(a) paid by a corporation (other than a corporation described in paragraphs (a) to (f) of the definition "financial intermediary corporation") to a shareholder that had a substantial interest in the corporation at the time the dividend was paid,

(b) paid by a corporation that was a financial intermediary corporation or a private holding corporation at the time the dividend was paid, or

(c) paid by a particular corporation that would, but for paragraph (h) or (i) of the definition "financial intermediary corporation", have been a financial intermediary corporation at the time the dividend was paid, except where the dividend was paid to a controlling corporation in respect of the particular corporation or to a specified person (within the meaning assigned by paragraph (h) of the definition "taxable preferred share" in subsection 248(1)) in relation to such a controlling corporation;

"financial intermediary corporation"

"financial intermediary corporation" means a corporation that is

(a) a corporation described in clause 146 (1)(j)(ii)(B)

(b) an investment corporation,

(c) a mortgage investment corporation,

(d) a mutual fund corporation,

(e) a prescribed venture capital corporation, or

(f) a prescribed labour-sponsored venture capital corporation,

but does not include

(g) a prescribed corporation,

(h) a corporation that is controlled directly or indirectly in any manner whatever, whether by reason of a beneficial interest in one or more trusts or otherwise, by or for the benefit of one or more corporations (each of which is referred to in this section as a controlling corporation) other than financial intermediary corporations or private holding corporations unless the controlling corporations and specified persons (within the meaning assigned by paragraph (h) of the definition "taxable preferred share" in subsection 248(1)) in relation to the controlling corporations do not own in aggregate shares of the capital stock of the corporation having a fair market value of more than 10% of the fair market value of all of the issued and outstanding shares of the capital stock of the corporation (such fair market values being determined without regard to any voting rights attaching to such shares), or

(i) a corporation in which a corporation other than a financial intermediary corporation or a private holding corporation has a substantial interest;

"private holding corporation"

"private holding corporation" means a private corporation

(a) that does not own shares of another corporation (other than shares of another private holding corporation or a financial intermediary corporation) in which it has a substantial interest, and

(b) the only undertaking of which is the investing of its funds,

but does not include

(c) a specified financial institution,

(d) a corporation that is controlled directly or indirectly in any manner whatever, whether by reason of a beneficial interest in one or more trusts or otherwise, by or for the benefit of one or more corporations other than private holding corporations, or

(e) a corporation in which another corporation (other than a private holding corporation) owns shares and has a substantial interest.

Substantial interest

(2) For the purposes of this Part, a shareholder has a substantial interest in a corporation at any time if the corporation is a taxable Canadian corporation and

(a) the shareholder is related (otherwise than by reason of a right referred to in paragraph 251(5)(b)) to the corporation at that time; or

(b) the shareholder owned, at that time,

(i) shares of the capital stock of the corporation that would give the shareholder 25% or more of the votes that could be cast under all circumstances at an annual meeting of shareholders of the corporation,

(ii) shares of the capital stock of the corporation having a fair market value of 25% or more of the fair market value of all the issued shares of the capital stock of the corporation, and

(iii) shares (other than taxable preferred shares or shares that would be taxable preferred shares if they were issued after June 18, 1987 and were not grandfathered shares) of the capital stock of the corporation having a fair market value of 25% or more of the fair market value of all of the issued shares of the capital stock of the corporation, (other than taxable preferred shares or shares that would be taxable preferred shares if they were issued after June 18, 1987 and were not grandfathered shares),

and for the purposes of this paragraph, a shareholder shall be deemed to own at any time each share of the capital stock of a corporation that is owned, otherwise than by reason of this paragraph, at that time by a person to whom the shareholder is related (otherwise than by reason of a right referred to in paragraph 251(5)(b)).

Idem

(3) Notwithstanding subsection (2)

(a) where it may reasonably be considered, having regard to all the circumstances, that the principal purpose for a shareholder acquiring an interest that would, but for this subsection, be a substantial interest in a corporation is to avoid or limit the application of Part IV.1 or this Part, the shareholder shall be deemed not to have a substantial interest in the corporation;

(b) a financial intermediary corporation shall be deemed not to have a substantial interest in another corporation unless it is related (otherwise than by reason of a right referred to in paragraph 251(5)(b)) to the other corporation; and

(c) any partnership or trust (other than a trust in which all persons who are beneficially interested, within the meaning assigned by subsection 94(7), are related to each other otherwise than by reason of a right referred to in paragraph 251(5)(b)) shall be deemed not to have a substantial interest in a corporation.

Reorganizations

(4) Where a share of its capital stock is issued by a corporation

(a) in the course of a reorganization of its business or capital stock, and the terms and conditions of the share or an agreement in respect of the share entered into as part of the reorganization provide that the share is to be redeemed, acquired or cancelled in the course of the reorganization,

(b) solely for the purpose of the reorganization and not to raise capital or as part of a series of transactions the purpose of which was to raise capital, and

(c) for consideration that does not include a taxable preferred share of the corporation or any right in respect thereto,

the amount of any dividend deemed to have been paid under subsection 84(2) or (3) on the redemption, acquisition or cancellation of the share of the corporation shall for the purposes of this Part and section 187.2 be deemed to be an

excluded dividend or excepted dividend, as the case may be, except to the extent that the amount paid on the redemption, acquisition or cancellation of the share exceeds the fair market value of the share immediately after it was issued and for the purposes of this subsection, a share issued by a corporation for consideration that is property of another corporation in the course of a reorganization in the course of which there is received a dividend on the share to which subsection 55(2) does not apply by reason of paragraph 55(3)(b), or would not apply for such reason if the dividend were attributable to anything other than income earned or realized by any corporation after 1971, shall be deemed not to have been issued to raise capital or as part of a series of transactions the purpose of which was to raise capital.

Deemed dividends

(5) Where at any time

(a) the terms or conditions of a share of the capital stock of a corporation (other than a taxable preferred share) are changed or established, or

(b) an agreement in respect of a share other than a taxable preferred share is changed or entered into

relating to the redemption, acquisition or cancellation of the share and the share is redeemed, acquired or cancelled within 12 months of that time, the amount of any dividend deemed to have been paid under subsection 84(2) or (3) on the redemption, acquisition or cancellation of the share shall for the purposes of this Part and section 187.2 be deemed to be an excluded dividend or excepted dividend, as the case may be, except to the extent that the amount paid on the redemption, acquisition or cancellation exceeds the fair market value of the share immediately after that time.

Tax on taxable dividends

191.1(1) Every taxable Canadian corporation shall pay a tax under this Part for each taxation year of an amount equal to the amount, if any, by which

(a) the aggregate of

(i) 66 2/3% of the amount, if any, by which the aggregate of all taxable dividends (other than excluded dividends) paid by the corporation in the year and after 1987 on short-term preferred shares exceeds the corporation's dividend allowance for the year,

(ii) 40% of the amount, if any, by which the aggregate of all taxable dividends (other than excluded dividends) paid by the corporation in the year and after 1987 on taxable preferred shares (other than short-term preferred shares) of all classes in respect of which an election under subsection 191.2(1) has been made exceeds the amount, if any, by which the corporation's dividend allowance for the year exceeds the aggregate of the dividends referred to in subparagraph (i),

(iii) 25% of the amount, if any, by which the aggregate of all taxable dividends (other than excluded dividends) paid by the corporation in the year and after 1987 on taxable preferred shares (other than short-term preferred shares) of all classes in respect of which an election under subsection 191.2(1) has not been made exceeds the amount, if any, by which the corporation's dividend allowance for the year exceeds the aggregate of the dividends referred to in subparagraphs (i) and (ii), and

(iv) the aggregate of all amounts each of which is an amount determined for the year in respect of the corporation under paragraph 191.3(1)(d)

exceeds

(b) the aggregate of all amounts each of which is an amount determined for the year in respect of the corporation under paragraph 191.3(1)(c).

Dividend allowance

(2) For the purposes of this section, a corporation's "dividend allowance" for a taxation year is the amount, if any, by which

(a) $500,000

exceeds

(b) the amount, if any, by which the aggregate of taxable dividends (other than excluded dividends) paid by it on taxable preferred shares, or shares that would be taxable preferred shares if they were issued after June 18, 1987 and were not grandfathered shares, in the calendar year immediately preceding the calendar year in which the taxation year ended exceeds $1,000,000,

unless the corporation is associated in the taxation year with one or more other taxable Canadian corporations, in which case, except as otherwise provided in this section, its dividend allowance for the year is nil.

Associated corporations

(3) If all of the taxable Canadian corporations that are associated with each other in a taxation year and that have paid taxable dividends (other than excluded dividends) on taxable preferred shares in the year have filed with the Minister in prescribed form an agreement whereby, for the purposes of this section, they allocate an amount to one or more of them for the taxation year, and the amount so allocated or the aggregate of the amounts so allocated, as the case may be, is equal to the total dividend allowance for the year for those corporations and all other taxable Canadian corporations with which each such corporation is associated in the year, the dividend allowance for the year for each of the corporations is the amount so allocated to it.

Total dividend allowance

(4) For the purposes of this section, the "total dividend allowance" for a group of taxable Canadian corporations that are associated with each other in a taxation year is the amount, if any, by which

(a) $500,000

exceeds

(b) the amount, if any, by which the aggregate of taxable dividends (other than excluded dividends) paid by those corporations on taxable preferred shares, or shares that would be taxable preferred shares if they were issued after June 18, 1987 and were not grandfathered shares, in the calendar year immediately preceding the calendar year in which the taxation year ended exceeds $1,000,000.

Failure to file agreement

(5) If any of the taxable Canadian corporations that are associated with each other in a taxation year and that have paid taxable dividends (other than excluded dividends) on taxable preferred shares in the year has failed to file with the Minister an agreement as contemplated by subsection (3) within 30 days after notice in writing by the Minister has been forwarded to any

of them that such an agreement is required for the purpose of any assessment of tax under this Part, the Minister shall, for the purpose of this section, allocate an amount to one or more of them for the taxation year, which amount or the aggregate of which amounts, as the case may be, shall equal the total dividend allowance for the year for those corporations and all other taxable Canadian corporations with which each such corporation is associated in the year, and the dividend allowance for the year of each of the corporations is the amount so allocated to it.

Dividend allowance in short years

(6) Notwithstanding any other provision of this section,

(a) where a corporation has a taxation year that is less than 51 weeks, its dividend allowance for the year is that proportion of its dividend allowance for the year determined without reference to this paragraph that the number of days in the year is of 365; and

(b) where a taxable Canadian corporation (in this paragraph referred to as the "first corporation") has more than one taxation year ending in a calendar year and is associated in two or more of those taxation years with another taxable Canadian corporation that has a taxation year ending in that calendar year, the dividend allowance of the first corporation for each taxation year in which it is associated with the other corporation ending in that calendar year is, subject to the application of paragraph (a), an amount equal to the amount that would be its dividend allowance for the first such taxation year if such allowance were determined without reference to paragraph (a).

Election

191.2(1) For the purposes of determining the tax payable by reason of subparagraphs 191.1(1)(a)(ii) and (iii), a taxable Canadian corporation (other than a financial intermediary corporation or a private holding corporation) may make an election with respect to a class of its taxable preferred shares the terms and conditions of which require an election to be made under this subsection by filing a prescribed form with the Minister not later than the day on or before which its return of income under Part I is required by section 150 to be filed for the taxation year in which shares of that class are first issued or first become taxable preferred shares.

Time of election

(2) An election with respect to a class of taxable preferred shares filed under and in accordance with subsection (1) shall be deemed to have been filed before any dividend on a share of that class is paid.

Agreement respecting liability for tax

191.3(1) Where a corporation (in this section referred to as the "parent corporation") and a taxable Canadian corporation (in this section referred to as the "controlled corporation") controlled by the parent corporation

(a) throughout a taxation year of the parent corporation, and

(b) throughout the last taxation year of the controlled corporation ending at or before the end of that taxation year of the parent corporation,

file as provided in subsection (2) an agreement or amended agreement with the Minister under which the controlled corporation agrees to pay all or any portion, as is specified in the agreement, of the tax for that taxation year of the parent corporation that would, but for the agreement, be payable under this Part by the parent corporation (other than any tax payable by the parent corporation by reason of another agreement made under this section), the following rules apply:

(c) the amount of tax specified in the agreement is an amount determined for that taxation year of the parent corporation in respect of the parent corporation for the purpose of paragraph 191.1(1)(b);

(d) the amount of tax specified in the agreement is an amount determined in respect of the controlled corporation for its last taxation year ending at or before the end of that taxation year of the parent corporation for the purpose of subparagraph 191.1(1)(a)(iv); and

(e) the parent corporation and the controlled corporation are jointly and severally liable to pay the amount of tax specified in the agreement and any interest or penalty in respect thereof.

Manner of filing agreement

(2) An agreement or amended agreement referred to in subsection (1) between a parent corporation and a controlled corporation shall be deemed not to have been filed with the Minister unless

(a) it is in prescribed form;

(b) it is filed on or before the day on or before which the parent corporation's return for the year in respect of which the agreement is filed is required to be filed under this Part or within the 90 day period commencing on the day of mailing of a notice of assessment of tax payable under this Part or Part I by the parent corporation for the year or by the controlled corporation for its taxation year ending in the calendar year in which the taxation year of the parent corporation ends or the mailing of a notification that no tax is payable under this Part or Part I for such taxation year;

(c) it is accompanied by,

(i) where the directors of the parent corporation are legally entitled to administer its affairs, a certified copy of their resolution authorizing the agreement to be made,

(ii) where the directors of the parent corporation are not legally entitled to administer its affairs, a certified copy of the document by which the person legally entitled to administer the corporation's affairs authorized the agreement to be made,

(iii) where the directors of the controlled corporation are legally entitled to administer its affairs, a certified copy of their resolution authorizing the agreement to be made, and

(iv) where the directors of the controlled corporation are not legally entitled to administer its affairs, a certified copy of the document by which the person legally entitled to administer the corporation's affairs authorized the agreement to be made; and

(d) where the agreement is not an agreement to which subsection (4) applies, an agreement amending the agreement has not been filed in accordance with this section.

Assessment

(3) Where an agreement or amended agreement between a parent corporation and a controlled corporation has been filed under this section with the Minister, the Minister shall, notwithstanding subsections 152(4) and (5), assess or reassess the tax, interest and penalties payable under this Act by the parent corporation and the controlled corporation for any relevant taxation year in order to take into account the agreement or amended agreement.

Change of Control

(4) Where, at any time, control of a corporation has been acquired and it may reasonably be considered that one of the main purposes of the acquisition was to transfer, by filing an agreement or an amended agreement under this section, the benefit of a deduction under paragraph 110(1)(k) in respect of an amount

(a) included in income or deducted in computing any balance of undeducted outlays, expenses or other amounts as a result of a subsequent disposition of a property owned by the corporation at that time or a property substituted therefor, and

(b) that may reasonably be considered to have accrued before that time

the amount of the tax specified in such agreement shall, for the purposes of paragraph (1)(c), be deemed to be nil.

Assessment of parent corporation

(5) The Minister may at any time assess a parent corporation in respect of any amount for which it is jointly and severally liable by reason of paragraph (1)(e) and the provisions of Division I of Part I are applicable in respect of the assessment as though it had been made under section 152.

Payment by parent corporation

(6) Where a parent corporation and a controlled corporation are by reason of paragraph (1)(e) jointly and severally liable in respect of tax payable by the controlled corporation under subparagraph 191.1(1)(a)(iv) and any interest or penalty in respect thereof, the following rules apply:

(a) a payment by the parent corporation on account of the liability shall, to the extent thereof, discharge the joint liability; but

(b) a payment by the controlled corporation on account of its liability discharges the parent corporation's liability only to the extent that the payment operates to reduce the controlled corporation's liability under this Act to an amount less than the amount in respect of which the parent corporation was, by paragraph (1)(e), made jointly and severally liable.

Information Return

191.4(1) Every corporation that is or would, but for section 191.3, be liable to pay tax under this Part for a taxation year shall, not later than the day on or before which it is required by section 150 to file its return of income for the year under Part I, file with the Minister a return for the year under this Part in prescribed form containing an estimate of the tax payable by it under this Part for the year.

Provisions applicable to Part

(2) Sections 152, 157, 158 and 159, subsections 161(1),(2) and (11), sections 162 to 167 and Division J of Part I are applicable to this Part with such modifications as the circumstances require". -

(2) Subsection (1) is applicable to the 1988 and subsequent taxation years.

(3) Where a dividend is paid at any time after December 15, 1987 and before 1988 on a share, and it may reasonably be considered, having regard to all the circumstances including the amount of any dividends that may be paid or declared on the share after 1987, that the dividend was paid at that time to avoid or limit the application of Part VI.1 of the said Act, as enacted by subsection (1), the dividend shall be deemed for the purposes of that Part to have been paid on January 1, 1988.

(4) Where a prescribed form referred to in subsection 191.2(1) of the said Act, as enacted by subsection (1), is filed on or before the day that is 6 months after the day on which this Act is assented to, it shall be deemed to have been filed on the day on or before which it is required by the said subsection 191.2(1) to be filed.

15.(1) Subsection 227(14) of the said Act is repealed and the following substituted therefor:

Application of Parts III, IV, IV.1 and VI.1

"(14) Parts III, IV, IV.1 and VI.1 are not applicable to any corporation for any period throughout which it is exempt from tax under section 149."

(2) Subsection (1) is applicable to the 1988 and subsequent taxation years.

16.(1) The definition "short-term preferred share" in subsection 248(1) of the said Act is repealed and the following substituted therefor:

"short-term preferred share"
«action privilégiée à court terme»

-""short-term preferred share" of a corporation at any particular time means a share, other than a grandfathered share, of the capital stock of the corporation issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 that at that particular time

(a) was a share where, under the terms and conditions of the share, any agreement relating to the share or any modification of such terms, conditions or agreement, the corporation or a specified person in relation to the corporation is or may, at any time within 5 years from the date of its issue, be required to redeem, acquire or cancel, in whole or in part, the share (unless the requirement to redeem, acquire or cancel the share arises only in the event of the death of the shareholder or by reason only of a right to convert or exchange the share) or to reduce the paid-up capital of the share and for the purposes of this paragraph an agreement in respect of a share of the capital stock of a corporation shall be read without reference to that part of the agreement under which a person agrees to acquire the share for an amount that approximates its fair market value at the time of the acquisition, determined without regard to the agreement, or for an amount determined by reference to the assets or earnings of the corporation where such determination may reasonably be considered to be used to approximate the fair market value of the share at the time of the acquisition, determined without regard to the agreement, or

(b) is a share that is convertible or exchangeable at any time within 5 years from the date of its issue, unless

(i) it is convertible or exchangeable only into

(A) another share of the corporation or a specified person in relation to the corporation that, if issued, would not be a short-term preferred share,

(B) a right or warrant that, if exercised, would allow the person exercising it to acquire a share of the corporation or a specified person in relation to the corporation that, if issued, would not be a short-term preferred share, or

(C) both a share described in clause (A) and a right or warrant described in clause (B), and

(ii) all the consideration receivable for the share on the conversion or exchange is the share described in clause (i)(A) or the right or warrant described in clause (i)(B) or both, as the case may be,

and for the purposes of this definition,

(c) where at any particular time after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, otherwise than pursuant to a written arrangement to do so entered into before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, the terms or conditions of a share of the capital stock of a corporation relating to the redemption, acquisition, cancellation, conversion or exchange of the share or to the reduction of the paid-up capital of the share by the corporation or a specified person in relation to the corporation have been modified or established or any agreement in respect of the share relating to any such event or any guarantee agreement (within the meaning assigned by paragraph (h)) in respect of the share, has been changed or entered into by the corporation or a specified person in relation to the corporation, the share shall be deemed after that particular time to have been issued at that particular time,

(d) where at any particular time after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, a particular share of the capital stock of a corporation has been issued or its terms or conditions have been modified or an agreement in respect of the share is modified or entered into, and it may reasonably be considered, having regard to all the circumstances, including the rate of interest on any debt obligation or the dividend provided on any short-term preferred share, that

(i) but for the existence at any time of such a debt obligation or such a short-term preferred share, the particular share would not have been issued or its terms or conditions modified or the agreement in respect of the share would not have been modified or entered into, and

(ii) one of the main purposes for the issue of the particular share or the modification of its terms or conditions or the modification or entering into the agreement in respect of the share was to avoid or limit the taxes payable under subsection 191.1(1),

the particular share shall be deemed after that particular time to have been issued at that particular time and to be a short-term preferred share of the corporation,

(e) where at any particular time after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, otherwise than pursuant to a written arrangement to do so entered into before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, the terms or conditions of a share of the capital stock of a corporation are modified or established or any agreement in respect of the share has been changed or entered into, and as a consequence thereof the corporation or a specified person in relation to the corporation may reasonably be expected to redeem, acquire or cancel (otherwise than by reason of the death of the shareholder or by reason only of a right to convert or exchange the share that would not cause the share to be a short-term preferred share by reason of paragraph (b)), in whole or in part, the share, or to reduce its paid-up capital, within 5 years from the date of its issuance or acquisition, the share shall be deemed after that particular time to have been issued at that particular time and to be a short-term preferred share of the corporation,

(f) where a share of the capital stock of a corporation was issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 and at the time the share was issued the existence of the corporation was, or there was an arrangement under which it could be, limited to a period that was within 5 years from the date of its issue, the share shall be deemed to be a short-term preferred share of the corporation,

(g) where a share of the capital stock of a corporation is acquired at any time after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 by the corporation or a specified person in relation to the corporation and the share is at any particular time after that time acquired by a person with whom the corporation or a specified person in relation to the corporation was dealing at arm's length (otherwise than by reason of a right referred to in paragraph 251(5)(b)), from the corporation or a specified person in relation to the corporation the share shall be deemed after that particular time to have been issued at that particular time,

(h) where at any particular time after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, otherwise than pursuant to a written arrangement to do so entered into before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, as a result of the terms or conditions of a share of the capital stock of a corporation or any agreement entered into by the corporation or a specified person in relation to the corporation, any person (other than the corporation or an individual other than a trust) was obligated, either absolutely or contingently and either immediately or in the future, to effect any undertaking (in this paragraph referred to as a "guarantee agreement") including any guarantee, covenant or agreement to purchase or repurchase the share, and including the lending of funds or the placing of amounts on deposit with, or on behalf of the shareholder or a specified person in relation to the shareholder given

> (i) to ensure that any loss that the shareholder or a specified person in relation to the shareholder may realize within 5 years after the date that the share was issued or acquired, by reason of the ownership, holding or disposition of the share or any other property is limited in any respect, and
>
> (ii) as part of a transaction or event or series of transactions or events that included the issuance or acquisition of the share,

the share shall be deemed after that particular time to have been issued at the particular time and to be at and immediately after the particular time a short-term preferred share, and for the purposes of this paragraph, where a guarantee agreement in respect of a share is given at any particular time after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, otherwise than pursuant to a written

arrangement to do so entered into before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, the share shall be deemed to have been issued at the particular time and the guarantee agreement shall be deemed to have been given as part of a series of transactions that included the issuance or acquisition of the share,

(i) a share that is, at the time a dividend is paid thereon, a share described in paragraph (e) of the definition "term preferred share" in this subsection during the applicable time period referred to in that paragraph or a prescribed share shall, notwithstanding any other provision of this definition, be deemed not to be a short-term preferred share at that time, and

(j) "specified person" has the meaning assigned by paragraph (h) of the definition "taxable preferred share" in this subsection;" -

(2) Subsection 248(1) of the said Act is amended by adding thereto, in alphabetical order within the subsection the following definitions:

"grandfathered share"
«action de régime transitoire»

-""grandfathered share" means

(a) a share of the capital stock of a corporation issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 pursuant to an agreement in writing entered into before that time,

(b) a share of the capital stock of a corporation issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 and before 1988 as part of a distribution to the public made pursuant to and in accordance with the terms of a prospectus, preliminary prospectus, registration statement, offering memorandum or notice filed before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 with a public authority pursuant to and in accordance with the securities legislation of the jurisdiction in which the shares are distributed,

(c) a share (in this paragraph referred to as the "new share") of the capital stock of a corporation that is issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 in exchange for

(i) a share of a corporation that was issued before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 or is a grandfathered share, or

(ii) a debt obligation of a corporation which was issued before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, or issued after that time pursuant to an agreement in writing entered into before that time

where the right to the exchange and all or substantially all the terms and conditions of the new share were established in writing before that time, and

(d) a share of the capital stock of a Canadian corporation listed on a prescribed stock exchange that is issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 upon the exercise of a right

(i) that was issued before that time and listed on a prescribed stock exchange in Canada, and

(ii) the terms of which at that time included the right to acquire the share,

where all or substantially all the terms and conditions of the share were established in writing before that time,

except that a share that is deemed under subsection 112(2.2) or the definition "short-term preferred share", "taxable preferred share" or "term preferred share" to have been issued at any time shall be deemed after that time not to be a grandfathered share for the purposes of that provision;

"restricted financial institution"
« institution financière véritable»

"restricted financial institution" means

(a) a bank to which the Bank Act or the Quebec Savings Banks Act applies,

(b) a corporation licensed or otherwise authorized under the laws of Canada or a province to carry on in Canada the business of offering to the public its services as trustee,

(c) a credit union,

(d) an insurance corporation,

(e) a corporation whose principal business is the lending of money or the purchasing of debt obligations or a combination thereof, or

(f) a corporation that is controlled by one or more corporations described in any of paragraphs (a) to (e);

"specified financial institution"
«institution financière désignée»

"specified financial institution" means

(a) a bank to which the Bank Act or the Quebec Savings Banks Act applies,

(b) a corporation licensed or otherwise authorized under the laws of Canada or a province to carry on in Canada the business of offering to the public its services as trustee,

(c) a credit union,

(d) an insurance corporation,

(e) a corporation whose principal business is the lending of money or the purchasing of debt obligations or a combination thereof,

(f) a corporation that is controlled by one or more corporations described in any of paragraphs (a) to (e) and for the purposes of this paragraph, one corporation is controlled by another corporation if more than 50% of its issued share capital (having full voting rights under all circumstances) belongs to the other corporation, to persons with whom the other corporation does not deal at arm's length, or to the other corporation and persons with whom the other corporation does not deal at arm's length, or

(g) a corporation associated with a corporation described in any of paragraphs (a) to (f);

"taxable preferred share"
«action privilégiée imposable»

"taxable preferred share" at any particular time means

(a) a share that is a short-term preferred share at that particular time, and

(b) a share (other than a grandfathered share) of the capital stock of a corporation issued after 8:00 p.m Eastern Daylight Saving Time, June 18, 1987 where, at that particular time by reason of the terms or conditions of the share or any agreement in respect of the share or its issue to which the corporation, or a specified person in relation to the corporation, is a party,

(i) it may reasonably be considered, having regard to all the circumstances, that the amount of the dividends that may be declared or paid on the share (in this definition referred to as the "dividend entitlement") is, by way of a formula or otherwise

(A) fixed,

(B) limited to a maximum, or

(C) established to be not less than a minimum (including any amount determined on a cumulative basis) and with respect to the dividend that may be declared or paid on the share there is a preference over any other dividend that may be declared or paid on any other share of the capital stock of the corporation,

(ii) it may reasonably be considered, having regard to all the circumstances, that the amount that the shareholder is entitled to receive in respect of the share on the dissolution, liquidation or winding-up of the corporation or on the redemption, acquisition or cancellation of the share or on a reduction of the paid-up capital of the share (unless the requirement to redeem, acquire or cancel the share arises only in the event of the death of the shareholder or by reason of a conversion or exchange of the share) by the corporation or by a specified person in relation to the corporation (in this definition referred to as the "liquidation entitlement") is, by way of a formula or otherwise

(A) fixed,

(B) limited to a maximum, or

(C) established to be not less than a minimum,

(iii) the share is convertible or exchangeable at any time, unless

(A) it is convertible or exchangeable only into

(I) another share of the corporation or a specified person in relation to the corporation that, if issued, would not be a taxable preferred share,

(II) a right or warrant that, if exercised, would allow the person exercising it to acquire a share of the corporation or a specified person in relation to the corporation that, if issued, would not be a taxable preferred share, or

(III) both a share described in subclause (I) and a right or warrant described in subclause (II), and

(B) all the consideration receivable for the share on the conversion or exchange is the share described in subclause (A)(I) or the right or warrant described in subclause (A)(II) or both, as the case may be, or

(iv) any person (other than the corporation) was, at or immediately before that particular time, obligated, either absolutely or contingently, and either immediately or in the future, to effect any undertaking (in this subparagraph referred to as a "guarantee agreement), including any guarantee, covenant or agreement to purchase or repurchase the share, and including the lending of funds to or the placing of amounts on deposit with, or on behalf of, the shareholder or any specified person in relation to the shareholder given

(A) to ensure that any loss that the shareholder or a specified person in relation to the shareholder may sustain by reason of the ownership, holding or disposition of the share or any other property is limited in any respect, or

(B) to ensure that the shareholder or a specified person in relation to the shareholder will derive earnings by reason of the ownership, holding or disposition of the share or any other property,

(C) as part of a transaction or event or a series of transactions or events that included the issuance or acquisition of the share,

and for the purposes of this subparagraph, where a guarantee agreement in respect of a share is given at any particular time after 8:00 p.m. Easter Daylight Saving Time, June 18, 1987, otherwise than pursuant to a written arrangement to do so entered into before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, the share shall be deemed to have been issued at the particular time and the guarantee agreement shall be deemed to have been given as part of a series of transactions that included the issuance or acquisition of the share; and

but does not include a share that is at the particular time a prescribed share or a share described in paragraph (e) of the definition "term preferred share" in this subsection during the applicable time period referred to in that paragraph and, for the purposes of this definition,

(c) the dividend entitlement of a share of the capital stock of a corporation shall be deemed not to be fixed, limited to a maximum or established to be not less than a minimum where all dividends on the share are determined solely by reference to a multiple or fraction of the dividend entitlement of another share of the capital stock of the corporation or of another corporation that controls the corporation that would not be a taxable preferred share if

(i) this definition were read without reference to paragraph (f),

(ii) the other share were issued after June 18, 1987, and

(iii) the other share were not a grandfathered share, a prescribed share or a share described in paragraph (e) of the definition "term preferred share",

(d) the liquidation entitlement of a share of the capital stock of a corporation shall be deemed not to be fixed, limited to a maximum or established to be not less than a minimum where all the liquidation entitlement is determinable solely by reference to the liquidation entitlement of another share of the capital stock of the corporation or of another corporation that controls the corporation that would not be a taxable preferred share if

(i) this definition were read without reference to paragraph (f),

(ii) the other share were issued after June 18, 1987, and

(iii) the other share were not a grandfathered share, a prescribed share or a share described in paragraph (e) of the definition "term preferred share",

(e) where at any particular time after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, otherwise than pursuant to a written arrangement to do so entered into before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, the terms or conditions of a share of the capital stock of a corporation that are relevant to any matter referred to in any of subparagraphs (b)(i) to (iv) are established or modified or any existing agreement in respect of any such matter, to which the corporation or a specified person in relation to the corporation is a party, is changed or an agreement in respect of any such matter to which the corporation or a specified person in relation to the corporation is a party, is entered into, the share shall, for the purpose of determining after the particular time whether it is a taxable preferred share, be deemed to have been issued at that particular time, unless

(i) the share is a share described in paragraph (b) of the definition "grandfathered share", and

(ii) the particular time is before December 16, 1987 and before the time at which the share is first issued,

(f) an agreement in respect of a share of the capital stock of a corporation shall be read without reference to that part of the agreement under which a person agrees to acquire the share for an amount that approximates its fair market value at the time of the acquisition, determined without regard to the agreement or for an amount determined by reference to the assets or earnings of the corporation where such determination may reasonably be considered to be used to approximate the fair market value of the share at the time of the acquisition, determined without regard to the agreement,

(g) where

(i) it may reasonably be considered that the dividends that may be declared or paid to a shareholder at any time on a share (other than a grandfathered share) of the capital stock of a corporation issued after December 15, 1987 are derived primarily from dividends received on taxable preferred shares of another corporation in which the corporation has a substantial interest (within the meaning of section 191) at that time, and

(ii) it may reasonably be considered that the share was issued or acquired as part of a transaction or event or series of transactions or events one of the main purposes of which was to avoid or limit the application of Part IV.1 or VI.1

the share shall be deemed at that time to be a taxable preferred share and the shareholder shall be deemed not to have a substantial interest (as determined under section 191) in the corporation at that time,

(h) "specified person", in relation to any particular person means another person with whom the particular person does not deal at arm's length or any partnership or trust of which the particular person or the other person is a member or beneficiary, respectively;

"taxable RFI share"
«action particulière à une institution financière»

"taxable RFI share" at any particular time means a share of the capital stock of a corporation issued before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 or a grandfathered share of the capital stock of a corporation, where at the particular time under the terms or conditions of the share or any agreement in respect of that share,

(a) it may reasonably be considered, having regard to all the circumstances, that the amount of the dividends that may be declared or paid on the share (in this definition referred to as the "dividend entitlement") is, by way of a formula or otherwise

(i) fixed,

(ii) limited to a maximum, or

(iii) established to be not less than a minimum, or

(b) it may reasonably be considered, having regard to all the circumstances, that the amount that the shareholder is entitled to receive in respect of the share on dissolution, liquidation or winding-up of the corporation (in this definition referred to as the "liquidation entitlement") is, by way of formula or otherwise

(i) fixed,

(ii) limited to a maximum, or

(iii) established to be not less than a minimum,

but does not include a share that is at the particular time a prescribed share, a term preferred share, a share described in paragraph (e) of the definition "term preferred share" in this subsection during the applicable time period referred to in that paragraph or a taxable preferred share and for the purposes of this definition

(c) the dividend entitlement of a share of the capital stock of a corporation shall be deemed not to be fixed, limited to a maximum or established to be not less than a minimum where all dividends on the share are determined solely by reference to a multiple or fraction of the dividend entitlement of another share of the capital stock of the corporation or of another corporation that controls the corporation that would not be a taxable preferred share if

(i) the definition "taxable preferred share" were read without reference to paragraph (f) thereof,

(ii) the other share were issued after June 18, 1987, and

(iii) the other share were not a grandfathered share, a prescribed share or a share described in paragraph (e) of the definition "term preferred share",

(d) the liquidation entitlement of a share of the capital stock of a corporation shall be deemed not to be fixed, limited to a maximum or established to be not less than a minimum where all the liquidation entitlement is determinable solely by reference to the liquidation entitlement of another share the capital stock of the corporation or of another corporation that controls the corporation that would not be a taxable preferred share if

(i) the definition "taxable preferred share" were read without reference to paragraph (f) thereof,

(ii) the other share were issued after June 18, 1987, and

(iii) the other share were not a grandfathered share, a prescribed share or a share described in paragraph (e) of the definition "term preferred share", and

(e) where it may reasonably be considered that the dividends that may be declared or paid to a shareholder at any time on a share of the capital stock of a corporation issued after December 15, 1987 are derived primarily from dividends received on taxable RFI shares of another corporation and the share was issued or acquired as part of a transaction or event or series of transactions or events one of the main purposes of which was to avoid or limit the application of Part IV.1, the share shall be deemed at that time to be a taxable RFI share and the shareholder shall be deemed not to have a substantial interest (as determined under section 191) in the corporation at that time;" -

(3) The definition "amount" in subsection 248(1) of the said Act is repealed and the following substituted therefor:

"amount"
«montant ou somme»

""amount" means money, rights or things expressed in terms of the amount of money or the value in terms of money of the right or thing, except that

(a) notwithstanding paragraph (b), in any case where subsection 112(2.1), (2.2) or (2.4), or section 187.2 or 187.3 or subsection 258(3) or (5) applies to a stock dividend, the "amount" of the stock dividend is the greater of

(i) the amount by which the paid-up capital of the corporation that paid the dividend is increased by reason of the payment of the dividend, and

(ii) the fair market value of the share or shares paid as a stock dividend at the time of payment,

(b) in any case where section 191.1 applies to a stock dividend, the "amount" of the stock dividend for the purposes of Part VI.1 is the greater of

(i) the amount by which the paid-up capital of the corporation that paid the dividend is increased by reason of the payment of the dividend, and

(ii) the fair market value of the share or shares paid as a stock dividend at the time of payment,

and for any other purpose the amount referred to in subparagraph (i), and

(c) in any other case, the "amount" of any stock dividend is the amount by which the paid-up capital of the corporation that paid the dividend is increased by reason of the payment of the dividend;"

(4) Subparagraph (e)(iii) of the definition "term preferred share" in subsection 248(1) of the said Act is repealed and the following substituted therefor:

"(iii) at a time when, by reason of financial difficulty, the issuing corporation or another corporation resident in Canada with which it does not deal at arm's length was in default, or could reasonably be expected to default, on a debt obligation held by a person with whom the issuing corporation or the other corporation was dealing at arm's length and the share was issued either wholly or in substantial part and either directly or indirectly in exchange or substitution for that obligation or a part thereof,"

(5) The definition "term preferred share" in subsection 248(1) of the said Act is further amended by striking out the word "or" at the end of paragraph (e) thereof, by adding the word "or" at the end of paragraph (f) thereof and by adding thereto, immediately after paragraph (f) thereof, the following paragraph:

-"(f.1) that is a taxable preferred share (other than a share deemed by paragraph (e) of the definition "taxable preferred share" or paragraph (i.3) to have been issued after December 15, 1987) held by a specified financial institution that acquired the share

(i) before December 16, 1987, or

(ii) before 1989 pursuant to an agreement in writing entered into before December 16, 1987," -

(6) The definition "term preferred share" in subsection 248(1) of the Act is further amended by striking out the word "and" at the end of paragraph (i) thereof and by adding thereto, immediately after paragraph (i) thereof, the following paragraphs:

-"(i.1) for the purposes of applying subparagraphs (a)(i) and (ii) of this definition, an agreement shall be read without reference to that part of the agreement under which a person agrees to acquire the share for an amount that approximates its fair market value at the time of the acquisition, determined without regard to the agreement or for an amount determined by reference to the assets or earnings of the corporation where such determination may reasonably be considered to be used to approximate the fair market value of the share at the time of the acquisition, determined without regard to the agreement, or solely for a share of the corporation or a specified person (within the meaning assigned by paragraph (h) of the definition "taxable preferred share") in relation to the corporation, that is not a term preferred share,

(i.2) where it may reasonably be considered that the dividends that may be declared or paid at any time on a share of the capital stock of a corporation issued after December 15, 1987 are derived primarily from dividends received on term preferred shares of another corporation and the share was issued or acquired as part of a transaction or event or series of transactions or events one of the main purposes of which was to avoid or limit the application of subsection 112(2.1), the share shall be deemed at that time to be a term preferred share acquired in the ordinary course of business,

(i.3) where at any particular time after December 15, 1987, otherwise than pursuant to a written arrangement to do so entered into before December 16, 1987, the terms or conditions of a taxable preferred share of the capital stock of a corporation relating to any matter referred to in subparagraphs (a)(i) to (iv) have been modified or established, or any agreement in respect of the share relating to any such matter has been changed or entered into by the corporation or a specified person (within the meaning assigned by paragraph (h) of the definition "taxable prepared share")in relation to the corporation , the share shall be deemed after that particular time to have been issued at that particular time, and" -

(7) All that portion of the definition "term preferred share" in subsection 248(1) of the said Act following paragraph (j) thereof is repealed.

(8) Subsection 248(6) of the said Act is repealed and the following substituted therefor:

Series of Shares

"(6) In its application in relation to a corporation that has issued shares of a class of its capital stock in one or more series, a reference in this Act to the "class" shall be read, with such modifications as the circumstances require, as a reference to a "series of the class."

(9) Section 248 of the said Act is further amended by adding thereto the following subsection:

Interests in trusts and partnerships

- "(12) Where after November 12, 1981 a person has an interest in a trust or partnership, whether directly or indirectly through an interest in any other trust or partnership or in any manner whatever, the person shall, for the purposes of the definitions "income bond", "income debenture" and "term preferred share" in subsection (1), paragraph (h) of the definition "taxable preferred share" in subsection (1), subsections 84(4.2) to (4.4) and 112(2.6) and section 258 be deemed to be a beneficiary of the trust or a member of the partnership, as the case may be." -

(10) Subsections (1), (4),(7) and (8) and the definitions "grandfathered share" and "taxable preferred share" in subsection 248(1) of the said Act, as enacted by subsection (2), are applicable with respect to shares issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 and shares deemed by the said Act to have been issued after that time.

(11) The definitions "specified financial institution", "taxable RFI share" and paragraphs (f.1), (i.1) and (i.3) of the definition "term preferred share" in subsection 248(1) of the said Act, as enacted by subsections (2), (5) and (6), and subsection (9) are applicable after June 18, 1987.

(12) Subsection (3) is applicable with respect to dividends paid after June 18, 1987.

(13) Paragraph (i.2) of the definition "term preferred share" in subsection 248(1) of the said Act, as enacted by subsection (6), is applicable with respect to shares issued after December 15, 1987 and shares deemed to have been issued after that time by paragraph (i.3) of the definition "term preferred share" in subsection 248(1) of the said Act, as enacted by subsection (6).

17.(1) All that portion of subsection 256(7) of the said Act preceding paragraph (a) thereof is repealed and the following substituted therefor:

Control deemed not to be acquired

"(7) For the purposes of subsection 13(24), section 37, subsections 66(11), (11.4) and (11.5), 66.5(3), 66.7(10) and (11), 87(2.1), 88.(1.1) and (1.2), sections 111 and 127 and subsections 191.3(4) and 249(4)"

(2) Subsection (1) is applicable to acquisitions of control after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987.

18.(1) Subsection 258(1) of the said Act is repealed.

(2) Subsection 258(3) of the said Act is repealed and the following substituted therefor:

Deemed interest on preferred shares

"(3) For the purposes of paragraphs 12(1)(c) and (k) and sections 113 and 126 and subject to subsection (4), a dividend received in a taxation year on

(a) a term preferred share by a specified financial institution from a corporation not resident in Canada, or

-(b) any other share by any corporation from a corporation not resident in Canada, if the dividend would have been a dividend in respect of which no deduction could have been made under subsection 112(1) or (2) (by reason of subsection 112(2.2), as it read on June 17, 1987) if the payer corporation were a taxable Canadian corporation at the time the dividend was paid -

shall be deemed to be interest received in the year and not a dividend received on a share of the capital stock of a corporation."

(3) Section 258 is further amended by adding thereto the following subsection:

Deemed interest on certain shares

- "(5) For the purposes of paragraphs 12(1)(c) and (k) and sections 113 and 126, a dividend received after June 18, 1987 and in a taxation year from a corporation not resident in Canada, other than a corporation in which the recipient had or would have, if the corporation were a taxable Canadian corporation, a substantial interest (within the meaning assigned by section 191), on a share, if the dividend would have been a dividend in respect of which no deduction could have been made under subsection 112(1) or (2) (by reason of subsection 112(2.2) or (2.4)) if the payer corporation were a taxable Canadian corporation at the time the dividend was paid, shall be deemed to be interest received in the year and not a dividend received on a share of the capital stock of the payer corporation." -

(4) Subsection (1) is applicable with respect to reductions of paid-up capital after 1987.

(5) Subsection (2) is applicable with respect to dividends received or deemed by the said Act to be received on shares acquired after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987.

(6) Subsection (3) is applicable after June 18, 1987.

Draft Income Tax Regulations
Preferred Shares

DRAFT REGULATIONS

1. Section 3200 of the Income Tax Regulations is revoked and the following substituted therefor:

"3200. The following stock exchanges in Canada are hereby prescribed for the purposes of sections 47.1,70 and 89, subsection 112(2.2), sections 146, 146.2, 146.3, 149.1, 187.3 and 204, subsection 206(2) and section 206.1 of the Act and the definitions "grandfathered share" and "term preferred share" in subsection 248(1) of the Act:

(a) Alberta Stock Exchange;
(b) Montreal Stock Exchange;
(c) Toronto Stock Exchange;
(d) Vancouver Stock Exchange;
(e) Winnipeg Stock Exchange."

2.(1) Subsection 5301(1) of the said Regulations is revoked and the following substituted therefor:

"5301.(1) Subject to subsections (6) and (8), for the purposes of subsection 157(4) and 161(9) of the Act, the "first instalment base" of a corporation for a particular taxation year means the product obtained when the aggregate of

(a) the tax payable by the corporation under Part I of the Act for its taxation year immediately preceding the particular year computed without reference to sections 123.1, 127.2 and 127.3 thereof and before taking into consideration any amount referred to in any of subparagraphs 161(7)(a)(i) to (vii) thereof that was excluded or deducted, as the case may be, and

(b) the tax payable by the corporation under Part VI.1 of the Act for its taxation year immediately preceding the particular year,

is multiplied by the ratio that 365 is of the number of days in that preceding year."

(2) Subparagraph 5301(4)(a)(i) of the said Regulations is revoked and the following substituted therefor:

"(i) its "first instalment base" for the particular year means the aggregate of all amounts, each of which is equal to the product obtained when the aggregate of

(A) the tax payable under Part I of the Act, computed without reference to sections 123.1, 127.2 and 127.3 thereof and before taking into consideration any amount referred to in any of subparagraphs 161(7)(a)(i) to (vii) thereof that was excluded or deducted, as the case may be, and

(B) the tax payable under Part VI.1 of the Act

by a predecessor corporation (within the meaning assigned by section 87 of the Act) for its last taxation year is multiplied by the ratio that 365 is of the number of days in that year, and"

3. Subsection 6201(2) of the said Regulations is revoked and the following substituted therefor:

"(2) For the purposes of paragraph (f) of the definition "term preferred share" in subsection 248(1) of the Act, a share of a class of the capital stock of a corporation that

(a) is a share (other than a share that is deemed to have been issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987) issued before that time or a grandfathered share,

(b) was acquired after June 28, 1982 and last acquired before December 16, 1987, and

(c) is listed on a stock exchange referred to in section 3200

is a prescribed share with respect to another corporation that receives a dividend at any time in respect of the share unless dividends are received at that time by the other corporation or by the other corporation and specified persons in relation to the other corporation in respect of more than 10 per cent of the issued and outstanding shares of that class.

(2.1) For the purposes of paragraph (f) of the definition "term preferred share" in subsection 248(1) of the Act, a share of a class of the capital stock of a corporation that

(a) is a share (other than a share that is deemed to have been issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987) issued before that time or a grandfathered share,

(b) was acquired after December 15, 1987, and

(c) is listed on a stock exchange referred to in section 3200

is a prescribed share with respect to another corporation, other than a restricted financial institution, that receives a dividend at any time in respect of the share unless dividends are received at that time by the other corporation or by the other corporation and specified persons in relation to the other corporation in respect of more than 10 per cent of the issued and outstanding shares of that class.

(2.2) For the purposes of paragraph (f) of the definition "term preferred share" in subsection 248(1) of the Act, a share of a class of the capital stock of a corporation that

(a) was issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 (other than a grandfathered share that is not deemed to have been issued after that time), and

(b) is listed on a stock exchange referred to in section 3200

is a prescribed share with respect to another corporation that receives a dividend at any time in respect of the share unless dividends are received at that time by the other corporation or by the other corporation and specified persons in relation to the other corporation in respect of more than 10 per cent of the issued and outstanding shares of that class."

4. Subsection 6201(4) of the said Regulation is revoked and the following substituted therefor:

"(4) For the purposes of the definition "taxable RFI share" in subsection 248(1) of the Act, a share of a class of the capital stock of a corporation that

(a) was acquired before December 16, 1987, and

(b) is listed on a stock exchange referred to in section 3200

is a prescribed share with respect to another corporation that is a restricted financial institution that receives a dividend at any time in respect of the share unless dividends are received at that time by the other corporation or by the other corporation and restricted financial institutions related to the other corporation in respect of more than 10% of the issued and outstanding shares of that class, and for the purpose of this subsection, a share of the capital stock of a corporation acquired by a taxpayer after December 15, 1987 pursuant to an agreement in writing entered into before that time shall be deemed to have been acquired by that taxpayer before December 16, 1987.

(5) For the purpose of determining under subsection (2), (2.1), (2.2) or (4) the year in which a share of a class of the capital stock of a corporation was acquired by any taxpayer, shares of that class acquired by the taxpayer at any time before a disposition by him of shares of that class shall be deemed to have been disposed of before shares of that class acquired by him before that time.

(6) For the purposes of subsections (2), (2.1), (2.2) and (4) and (5) and this subsection,

(a) "specified person" has the meaning assigned by paragraph (h) of the definition "taxable preferred share" in subsection 248(1) of the Act;

(b) a reference to a taxpayer or person includes a partnership;

(c) where a taxpayer is a beneficiary of a trust and an amount in respect of the beneficiary has been designated by the trust in a taxation year pursuant to subsection 104(19) of the Act, the taxpayer shall be deemed to have received the amount so designated at the time it was received by the trust; and

(d) where a taxpayer is a member of a partnership and a dividend has been received by the partnership, the taxpayer's share of the dividend shall be deemed to have been received by the taxpayer at the time the dividend was received by the partnership."

5. All that portion of section 6700 of the said Regulations preceding paragraph (a) thereof is revoked and the following substituted therefor:

"6700. For the purposes of paragraph 40(2)(i), clause 53(2)(k)(i)(C), paragraph 125(7)(b), sections 186.1, 186.2 and 187.1 and subsection 191(1) of the Act and in this Part and Part LI, "prescribed venture capital corporation" means at any particular time"

6. Section 6701 of the said Regulations is revoked and the following substituted therefor:

"6701. For the purposes of paragraph 40(2)(i), clause 53(2)(k)(i)(C), the definition "approved share" in subsection 127.4(1), sections 186.1 and 187.1 and subsection 191(1) of the Act, the corporation established by an Act to Establish the Fonds de Solidarité des Travailleurs du Québec (F.T.Q.), Statutes of Quebec 1983, chapter 58, as amended, is a prescribed labour-sponsored venture capital corporation."

7. Section 1 is applicable after October 31, 1985.

8. Section 2 is applicable to the 1988 and subsequent taxation years.

9. Sections 3 to 6 are applicable after June 18, 1987.

Explanatory Notes
Preferred Shares

EXPLANATORY NOTES
PREFERRED SHARES

Introduction

Draft legislation with respect to the taxation of preferred shares was first released on June 18, 1987. The revised draft legislation released on December 16, 1987 reflects a number of changes. This introduction to the explanatory notes on the revised draft legislation provides an overall summary of the scheme of the legislation with specific comment on a number of the changes made to the June 18, 1987 draft.

The proposed system provides for a special tax on dividends paid on preferred shares issued after 8:00 p.m. EDT, June 18, 1987. There is also a tax on certain corporate recipients of dividends on certain types of preferred shares. The system contains a number of mechanisms designed to avoid the application of this system to smaller corporations, to dividends paid to related shareholders, to venture capital investments, to corporations that serve as flow-through vehicles such as mutual funds and to corporate reorganizations and estate plans where preferred shares may be used as a mechanism to accomplish objectives unrelated to the raising of capital.

The basic system

A tax will be payable by any corporation paying dividends after 1987 on "taxable preferred shares" -- generally all preferred shares issued after 8:00 p.m. EDT, June 18, 1987 -- other than dividends paid to shareholders related to the corporation or shareholders having a substantial interest (essentially 25 per cent of votes and value) in the corporation. The tax on the issuer corporation on dividends on such shares paid in a taxation year may be payable at a 66 2/3 per cent rate, a 40 per cent rate or a 25 per cent rate. Tax is payable only on dividends paid in a taxation year in excess of a threshold amount. The annual threshold is $500,000 for each corporation or associated group of corporations and is reduced to the extent of dividends on preferred shares (including such shares issued before June 18, 1987) paid in the preceding calendar year in excess of $1,000,000. In all cases a special mechanism will allow the tax on the issuer to be offset against corporate income taxes otherwise payable.

If a taxable preferred share is also a short-term preferred share (generally retractable within five years) the rate of tax will be 66 2/3 per cent. In the June 18, 1987 draft legislation, dividends on short-term preferred shares were denied the intercorporate dividend deduction as well as being subject to tax under Part VI.1 at a 25 per cent or 40 per cent rate. The revised draft legislation

restores the intercorporate dividend deduction for such dividends but applies the Part VI.1 tax at this higher rate. Dividends on short-term preferred shares will now, therefore, be covered by the $500,000 dividend allowance and the substantial interest exemption and generally be subject only to Part VI.1 tax which is offsettable against corporate income taxes otherwise payable.

If a taxable preferred share is not a short-term preferred share the tax payable by the issuer corporation will be 25 per cent of dividends on such shares. In addition to this 25 per cent tax on the dividend paying corporation, there will be a 10 per cent tax on the dividends where received by public corporations and specified financial institutions. A corporation that issues a class of taxable preferred shares may elect to be subject to a 40 per cent tax on dividends paid on shares of that class in lieu of the 25 per cent tax. In that case the 10 per cent tax payable on dividends received by specified financial institutions and public corporations will not be applicable. Taxable corporations are likely to make this election where the shares are expected to be held by specified financial institutions or other corporations that would otherwise be subject to the 10% tax on the receipt of the dividend.

The taxes on a corporation paying dividends on taxable preferred shares are imposed under new Part VI.1 of the Act. The tax payable is determined under new subsection 191.1. The $500,000 exemption threshold or "dividend allowance" is determined in new subsections 191.1(2) to (6). The amount of the exemption is subject to a clawback on a dollar-for-dollar basis with respect to dividends on taxable preferred shares (or shares that would be taxable preferred shares if they had been issued after June 18, 1987) in excess of $1,000,000 paid by the corporation and any other members of its corporate group (new subsection 191.1(2)) in the previous year. Excluded dividends (new subsection 191(1)) are exempt from the Part VI.1 tax. Excluded dividends include dividends paid to a shareholder holding a substantial interest (defined in new section 191) in the payer corporation and dividends paid by a financial intermediary corporation or a private holding corporation (these expressions are defined in new subsection 191(1)). The definition of substantial interest has been changed in the revised draft legislation to require a holding of shares with 25 per cent of the value of all issued shares of a corporation combined with a holding of common shares with 25 per cent of the value of all common shares of the corporation as well as shares to which are attached 25 per cent of the votes. Deemed dividends arising in many corporate reorganizations and restructurings of share capital are deemed to be excluded dividends (new subsections 191(4) and (5)). The tax under Part VI.1 is payable by monthly instalments (proposed amendments to sections 157 and 161). The election to pay the 40 per cent tax is provided in new section 191.2.

The 10 per cent tax on taxable preferred share dividends received by public corporations and specified financial institutions is dealt with in Part IV.1, specifically new section 187.2. The tax is not payable on dividends on short-term preferred shares (which are subject to a 66 2/3 per cent tax under Part VI.1) or shares in respect of which the dividend paying corporation has made the special election to pay the 40 per cent rate of tax under Part VI.1. The tax is also not payable on excepted dividends (defined in new section 187.1) which include dividends received from a corporation in which the recipient holds a substantial interest or dividends received by a private corporation or a financial intermediary corporation.

The offset mechanism for the Part VI.1 tax on dividend paying corporations is provided by way of a deduction in computing taxable income equal to 5/2 of the Part VI.1 tax payable in the year (new paragraph 110(1)(k)). The unused portion of this deduction will form part of the corporation's non-capital loss (proposed amendment to paragraph 111(8)(b)) and therefore be eligible for a 3-year carry-back and 7-year carry-forward. The deduction in computing taxable income either under 110(1)(k) for Part VI.1 tax payable in a year ending before July, 1988 or for a loss arising from a 110(1)(k) deduction in a subsequent year carried back to a year ending before July, 1988 has been restricted in the revised draft legislation to account for the higher rates of corporate tax in those earlier years (coming-into-force provisions with respect to new paragraph 110(1)(k) and the amendments to paragraph 111(8)(b)).

Where a parent corporation has Part VI.1 tax payable on its taxable preferred share dividends, it may by agreement transfer to a subsidiary its liability for all or a portion of the tax. This permits the parent to transfer its entitlement to the paragraph 110(1)(k) deduction for 5/2 of the tax to its subsidiary. Thus, for example, a holding company which has no corporate income tax payable may issue and pay dividends on taxable preferred shares and its subsidiaries will be able to claim the offset for the resulting Part VI.1 tax against the Part I corporate income taxes payable on their earnings (new section 191.3).

The definition "taxable preferred share" in subsection 248(1) of the Income Tax Act includes all shares that would conventionally be considered preferred shares. Shares that are common shares (fully-participating equity shares) are not included in the definition unless, through outside guarantee agreements to which the issuing corporation or a non-arm's length person is a party, they have the attributes of preferred shares. Shares issued before 8:00 p.m. EDT, June 18, 1987 will not be taxable preferred shares unless their terms or conditions are changed after that date. Shares issued after that time pursuant to a written agreement entered into or prospectus filed before that time are grandfathered as are shares

received on the conversion of an instrument issued before June 18, 1987 or the exercise of a publicly-listed warrant issued before that time (see definition "grandfathered share" in subsection 248(1)). A number of technical changes to the definition "taxable preferred share" have been made in the revised draft legislation.

Taxes under Part IV.1 and VI.1 are effective with respect to dividends paid on taxable preferred shares after 1987.

Clause 1
Dividends received
ITA
82(2)

Section 82 of the Act deals with the tax treatment of dividends received from corporations resident in Canada. Subsection 82(2) provides that dividends received by one taxpayer but included under certain attribution rules in computing the income of another taxpayer are treated as having been received by the other taxpayer for the purposes of section 82 (relating to the inclusion of dividends into income), section 112 (relating to the inter-corporate dividend deduction) and section 121 (relating to the dividend tax credit). The amendment to subsection 82(2) makes this rule applicable for all purposes of the Act. It will thus apply for the purposes of section 113 (relating to dividends from foreign affiliates) and section 258 (the special rules relating to income bonds and debentures and certain dividends from corporations not resident in Canada). The amendment will also have the effect of extending the application of subsection 82(2) for the purposes of the Part IV tax and the special tax imposed under new Part IV.1 on certain dividends received on taxable preferred shares and taxable RFI shares.

The amendment to subsection 82(2) is effective for dividends received after June 18, 1987.

Clause 2
Deemed dividends
ITA
84(4.2) to (4.4)

Subsections 84(1) to (4.1) of the Act provide that share redemptions and certain other transactions relating to shares of the capital stock of a corporation result in a deemed dividend. New subsections 84(4.2), (4.3) and (4.4) extend that treatment to certain transactions involving term preferred shares, taxable preferred shares and taxable RFI shares.

New subsection 84(4.2) replaces existing subsection 258(1) which is consequently repealed. Subsection 258(1) is applicable with respect to an amount received on the reduction of the paid-up capital of a term preferred share and, therefore, parallels the tax treatment under subsection 84(4.1) of an amount received on the reduction of the paid-up capital of a share of a public corporation. For that reason, section 84 is the more logical location in the Act for this provision.

New subsection 84(4.3) of the Act parallels the tax treatment under new subsection 84(4.2) but applies with respect to taxable preferred shares. Generally, where the paid-up capital of a share of the capital stock of a corporation that is not a public corporation is reduced otherwise than by transactions that result in a disposition of the share, a dividend is deemed to have been received by the shareholder only to the extent that the amount received exceeds the reduction of the paid-up capital of that share. This effectively allows a tax-free distribution to shareholders of an amount up to the paid-up capital of their shares. In the context of the new Part IV.1 and VI.1 taxes, such distributions would permit a shareholder to obtain a return of capital in lieu of dividends on a taxable preferred share in order to defer taxation until the share is sold. New subsection 84(4.3) provides that the total amount received by a shareholder on a reduction of the paid-up capital of any such share (rather than only that part of the amount that exceeds its paid-up capital) shall be treated as a dividend paid and received on the share.

New subsection 84(4.4) of the Act has a similar effect but is applicable with respect to taxable RFI shares. This subsection applies where the paid-up capital of such a share of the capital stock of a corporation that is not a public corporation is reduced otherwise than by a transaction that results in a disposition of the share and where, at that time, the share is owned by a restricted financial institution (defined in subsection 248(1)) or by a partnership or trust of which such a restricted financial institution is a member or beneficiary. Where these conditions are met, the total amount received by the shareholder on the reduction of the paid-up capital of any such share (rather than only that part of the amount that exceeds its paid-up capital) shall be treated as a dividend received on the share.

New subsections 84(4.2) to (4.4) are applicable with respect to reductions of paid-up capital after 1987.

Clause 3
Amalgamations
ITA
87

Section 87 of the Act deals with the tax treatment of an amalgamation of two or more corporations.

Subclause 3(1)
ITA
87(2)(rr) and (ss)

New paragraphs 87(2)(rr) and (ss) of the Act are consequential on the introduction of the special taxes in Parts IV.1 and VI.1 and on subsection 112(2.9).

New Part VI.1 provides for a special tax on certain dividends paid on taxable preferred shares in excess of an annual $500,000 threshold amount -- referred to in the Act as a dividend allowance. This allowance is determined for any taxation year by reference to dividends paid in the preceding calendar year. The reference in new paragraph 87(2)(rr) to new subsections 191.1(2) and (4) ensures that in computing the dividend allowance of an amalgamated corporation the dividends paid by its predecessor corporations in the previous calendar year are taken into account.

Subsection 112(2.9) prevents corporations from becoming related for the purpose of avoiding the denial of the deduction provided for in subsection 112(2.4) for dividends received from corporations other than related corporations. The reference in new paragraph 87(2)(rr) to subsection 112(2.9) ensures that, for the purpose of that subsection, an amalgamated corporation will be considered not to be related to another corporation where a predecessor corporation became related to that other corporation for the purpose of avoiding the application of subsection 112(2.4).

New subsection 191(4) exempts from the application of the new Parts IV.1 and VI.1 certain deemed dividends arising on the redemption, acquisition or cancellation of a share by a corporation in the course of a corporate reorganization. For this exception to apply, paragraph 191(4)(c) requires that the share must have been issued for consideration that does not include a taxable preferred share of the corporation. The reference in new paragraph 87(2)(rr) to paragraph 191(4)(c) ensures that the condition in paragraph 191(4)(c) will not be satisfied where a share of an amalgamated corporation is issued in consideration for a share of a predecessor corporation that was a taxable preferred share.

New section 191.3 allows a special election to be made for the purposes of the new Part VI.1 tax to permit a parent corporation to assign its liability for the tax on dividends paid by the parent on taxable preferred shares to a corporation that it controls. The reference to this section in paragraph 87(2)(ss) ensures that any such election remains valid where either corporation is amalgamated. For this purpose the amalgamated corporation is treated as being the same corporation as its predecessor corporations.

New paragraphs 87(2)(rr) and (ss) apply with respect to amalgamations after June 18, 1987.

Subclause 3(2)
ITA
87(4.2)

New subsection 87(4.2) of the Act is consequential on the introduction of new rules relating to the tax treatment of preferred shares. The status of certain preferred shares depends on their date of issue or acquisition. The purpose of this new subsection is to treat preferred shares issued on an amalgamation in exchange for substantially similar shares issued by a predecessor as having been issued when they were issued by the predecessor and under the same circumstances. This subsection treats these shares as having been acquired by the shareholder at the same time he acquired the exchanged shares. Thus, for example, where a share of a predecessor would have been a taxable preferred share but for the fact that it was issued before June 18, 1987, a new share issued on an amalgamation in exchange for that share will not be a taxable preferred share where it has substantially similar terms and conditions.

This subsection also applies to preserve any special election provided for in section 191.2 that had been made by a predecessor corporation before an amalgamation where the newly amalgamated corporation issues shares the terms and conditions of which are substantially the same as those of an elected class of shares of the predecessor.

This subsection applies with respect to amalgamations after November 27, 1986.

Subclauses 3(3) and (4)

These set out the effective dates for the amendments to section 87 of the Act.

Clause 4
Windings-Up
ITA
88

Section 88 of the Act sets out the rules that apply on the winding-up of a corporation.

Subclause 4(1)
ITA
88(1)(e.2)

Subsection 88(1) of the Act sets out rules that apply on the winding-up of a subsidiary into a parent corporation that owns at least 90 per cent of its shares. Under paragraph 88(1)(e.2) many of the detailed rules to be applied on a winding-up of a subsidiary into its parent are adopted by way of cross-reference to the corresponding provisions in section 87 relating to amalgamations. The amendment to paragraph 88(1)(e.2) is consequential on the new rules relating to the tax treatment of preferred shares. This amendment treats the parent corporation as the same corporation as the subsidiary corporation for the purposes of the provisions mentioned in new paragraph 87(2)(rr) which are discussed above. This amendment is applicable to windings-up ending after June 18, 1987.

Subclause 4(2)
ITA
88(1.1)(e)

Existing paragraph 88(1.1)(e) of the Act provides that where control of a parent or subsidiary corporation has been acquired special rules apply to restrict the ability of the parent following the winding-up of the subsidiary to deduct any non-capital losses or farm losses incurred by the subsidiary before the acquisition of control. In these circumstances the only losses of the subsidiary that will be available to the parent corporation will be the subsidiary's farm losses or non-capital losses that may reasonably be regarded as its losses from carrying on a business.

As discussed in the commentary on new paragraph 110(1)(k), the deduction provided by this paragraph effectively allows a corporation to offset the new Part VI.1 tax against its Part I tax liability. Under the amendment proposed to clause 111(8)(b)(i)(A), the unused portion of the deduction allowed by paragraph 110(1)(k) in a taxation year becomes part of the corporation's non-capital loss for the year. As such, it may then be carried over for deduction in the three preceding and seven subsequent taxation years. The amendment ensures that where there has been an acquisition of control of the

parent or subsidiary, the parent will be allowed in a subsequent taxation year to deduct that portion of the subsidiary's non-capital loss that may reasonably be regarded as being in respect of a deduction under new paragraph 110(1)(k) but only if the subsidiary carried on a business in the year in which the deduction arose and only to the extent of the parent's income from that business or from a similar business throughout the subsequent year. This amendment, which parallels similar amendments to subsection 111(5), is applicable with respect to non-capital losses and farm losses for the 1988 and subsequent taxation years.

Subclauses 4(3) and (4)

These set out the effective dates for the amendments to section 88 of the Act.

Clause 5
ITA
110(1)(k)

New paragraph 110(1)(k) of the Act provides a deduction in computing a corporation's taxable income equal to 2 1/2 times any tax payable by it for the year under Part VI.1 on dividends paid on taxable preferred shares. The purpose of this deduction is to permit an approximate offset of any Part VI.1 tax payable for a year against the corporate income tax payable either for the year or for another year through the non-capital loss carry-back and carry-forward mechanism.

This amendment is applicable to the 1988 and subsequent taxation years. In the case of taxation years ending before July 1988, however, the deduction allowed to a corporation under paragraph 110(1)(k) will be equal to 2 times, rather than 2 1/2 times, the tax payable for the year under Part VI.1. This adjustment takes into account the higher rate of corporate tax applicable to taxation years ending before July 1, 1988.

Clause 6
Losses
ITA
111

Section 111 of the Act sets out the rules relating to the carryover of losses.

Subclauses 6(1) and (2)
ITA
111(5)(a) and (b)

The amendments to paragraphs 111(5)(a) and (b) of the Act are consequential on the inclusion in non-capital losses of amounts deductible under new paragraph 110(1)(k). Without these changes and the change to paragraph 88(1.1)(e) which is discussed above, the amounts included in a corporation's non-capital loss resulting from a deduction under new paragraph 110(1)(k) would cease to qualify for carry-forward or carry-back after an acquisition of control of the corporation. The amendment to paragraph 111(5)(a) will ensure that, where there has been an acquisition of its control, a corporation will be allowed in a subsequent taxation year to deduct that portion of its non-capital loss or farm loss that may reasonably be regarded as being in respect of a deduction under new paragraph 110(1)(k), but only if the corporation carried on a business in the year in which the deduction arose and only to the extent of its income from that business or from a similar business throughout the subsequent year. The amendment to paragraph 111(5)(b) provides a similar rule with regard to the carry-back of a non-capital loss or farm loss realized after an acquisition of control. The amendments to these paragraphs are applicable with respect to non-capital losses and farm losses for the 1988 and subsequent taxation years.

Subclause 6(3)
ITA
111(8)(b)(i)(A)

The amendment to clause 111(8)(b)(i)(A) of the Act ensures that the unused part of the amount deductible under paragraph 110(1)(k) by a corporation (2 1/2 times its Part VI.1 taxes payable) will be included in the computation of its non-capital loss that is available for carryover to the preceding three and subsequent seven taxation years. The amount by which the non-capital loss will be increased is the unused portion of the paragraph 110(1)(k) deduction -- that is, the portion that did not reduce the corporation's taxable income for the year in which it was deductible. This amendment is applicable to the 1988 and subsequent taxation years subject to special rules discussed below (see commentary under subclause 6(5)).

Subclause 6(4)

This sets out the effective date for the amendments to paragraphs 111(5)(a) and (b) of the Act.

Subclause 6(5)

Subclause (5) sets out the effective date for the amendment to clause 111(8)(b)(i)(A) of the Act. This amendment is generally applicable to the 1988 and subsequent taxation years. However, when a corporation's non-capital loss for a taxation year ending after July 1, 1988 is carried back to a taxation year ending before that date, paragraph (a) provides that this non-capital loss shall be reduced in order to account for the fact that the deduction allowed to a corporation under paragraph 110(1)(k) for such a taxation year ending before that date is equal to 2, rather than 2 1/2, times its tax payable under Part VI.1. This reduction is one-fifth of the lesser of the deduction under paragraph 110(1)(k) and the non-capital loss otherwise computed. However, paragraph (c) provides that for the purposes of determining under subsection 111(3) of the Act which part of that non-capital loss has been so deducted in a taxation year ending before July 1, 1988, the amount of the non-capital loss that has been deducted in that year shall be computed without taking into account the reduction made under paragraph (a).

In the same way, when a corporation's non-capital loss for a taxation year ending before July 1, 1988 is carried forward to a taxation year ending after that date, a corresponding increase in the part of that non-capital loss that is attributable to a deduction under paragraph 110(1)(k) of the Act is appropriate. This is provided for in paragraph (b).

Clause 7
Taxable Dividends
ITA
112

Section 112 of the Act is one of the principal provisions dealing with the treatment of dividends received by a corporation resident in Canada from another corporation. Subsection 112(1) permits a corporation to deduct taxable dividends in computing its taxable income.

Subclause 7(1)
ITA
112(2.1) and (2.2)

Subsection 112(2.1) of the Act prevents a specified financial institution from deducting taxable dividends received on most term preferred shares in computing its taxable income. This subsection is amended as a consequence of the introduction of a definition of "specified financial institution" in subsection 248(1). A further amendment provides that a dividend received by a restricted financial

institution on a share of a mutual fund corporation or an investment corporation after that corporation has elected under new subsection 131(10) of the Act not to be treated as a restricted financial institution will be considered to have been paid on a term preferred share acquired in the ordinary course of business. These amendments applies after 8:00 p.m. EDT, June 18, 1987.

Subsection 112(2.2) of the Act denies the intercorporate dividend deduction for dividends on certain shares that are guaranteed by a specified financial institution. This subsection, as amended, generally applies to shares issued, or deemed to have been issued, after 8:00 p.m. EDT, June 18, 1987. It is applicable where a specified financial institution or a specified person in relation to any such institution has undertaken to protect a corporate shareholder with respect to the value or yield of a share. The amendments to paragraphs 112(2.2)(a) and (b) ensure that the intercorporate dividend deduction will not apply where a specified financial institution has provided a guarantee to the shareholder or a specified person in relation to the shareholder with respect to the share or dividend.

Subsection 112(2.2) as amended will also apply to a dividend on a particular share where a specified financial institution has guaranteed or insured the investment in, or return on, any share or other property that was issued or acquired and the guarantee was given as part of a transaction or event or a series of transactions or events that included the issuance or acquisition of the particular share. This ensures that this subsection will apply to dividends on shares that would not otherwise be subject to subsection 112(2.2) but are issued or acquired in conjunction with the guarantee of other shares or property.

Paragraph (c) provides that subsection 112(2.2) does not apply to a dividend received on a share that is not a term preferred share because it has been issued by a corporation in financial difficulty. Under new paragraph (d) amended subsection 112(2.2) will not apply with respect to dividends received on a prescribed share, a taxable preferred share issued before December 16, 1987 or a grandfathered share. However subsection 112(2.2), as it read before June 18, 1987, may apply to dividends received on a grandfathered share.

New paragraph (e) continues the exception provided by existing paragraph 112(2.2)(d) from the application of subsection 112(2.2) for publicly listed shares issued by a specified financial institution where all guarantee agreements in respect of these shares are given by the issuer or persons related thereto unless the shareholder and persons with whom the shareholder does not deal at arm's length (otherwise than by reason of a right referred to paragraph 251(5)(b)) receive dividends in respect of more than 10% of the guaranteed shares.

The changes to subsection 112(2.2) will generally apply only to dividends paid on shares issued after 8:00 p.m. EDT, June 18, 1987. However, amended subsection 112(2.2) will also apply to a share issued before that time where a guarantee in respect of the share has been provided after that time. New paragraph 112(2.2)(f) treats the share as having been issued at the time that such guarantee was provided.

New paragraph 112(2.2)(g) provides that for the purposes of subsection 112(2.2), the expression "specified person" in relation to a specified financial institution or to a corporate shareholder has the same meaning as provided in the definition of taxable preferred share in subsection 248(1) of the Act.

Subclause 7(2)
ITA
112(2.3)

Subsection 112(2.3) of the Act denies a deduction under subsection 112(1) or (2) to a corporation in respect of a dividend received by it on a short-term preferred share. This subsection is repealed with respect to dividends on short-term preferred shares issued after 8:00 p.m. EDT, June 18, 1987. Such dividends are now subject to a 66 2/3% special tax under new Part VI.1. This tax is payable by the issuer corporation but may be offset through the deduction provided by new subsection 110(1)(k) against the Part I tax liability of that corporation. Reference may be made to the commentary on section 191.1(1).

Subclause 7(3)
ITA
112(2.9)

Subsection 112(2.9) of the Act prevents corporations from becoming related for the purpose of avoiding the application of subsection 112(2.4) which denies the deduction of dividends on so-called collateralized preferred shares. This amendment clarifies the application of that anti-avoidance provision.

Subclauses 7(4), (5) and (6)

These set out the effective dates for the amendments to section 112 of the Act.

Clause 8
Mutual Fund Corporations
ITA
131(10)

New subsection 131(10) of the Act permits a mutual fund corporation or an investment corporation to elect not to be treated as a restricted financial institution within the meaning of that expression as defined in amended subsection 248(1) of Act. Dividends paid on shares of the mutual fund corporation or the investment corporation to a shareholder that is a restricted financial institution after this election has been made will be treated as having been paid on a term preferred share acquired in the ordinary course of business for the purposes of new subsection 112(2.1) of the Act.

This amendment is applicable after December 15, 1987, except that an election will be deemed to have been filed on time if it is filed within 6 months of the date on which the implementing legislation receives Royal Assent.

Clause 9
Dividends Received by Life Insurer
ITA
138(6)

Subsection 138(6) of the Act provides that, in computing the taxable income of a life insurer, taxable dividends received from taxable Canadian corporations (other than dividends on certain term preferred shares) may be deducted. Subsections 112(2.2) and (2.4), however, deny any deduction under subsection 138(6) with respect to certain dividends on so-called collateralized preferred shares and on shares the value or yield of which is guaranteed. The amendment to subsection 138(6) clarifies that no deduction may be made under subsection 138(6) where subsection 112(2.2) or (2.4) applies. This amendment is applicable with respect to dividends received after 8:00 p.m. EDT, June 18, 1987.

Clause 10
Instalments

Subclauses 10(1) and (2)
ITA
157(1)

Subparagraph 157(1)(a)(i) of the Act contains part of the formula by which a corporation calculates its Part I income tax instalments.

Subparagraph 157(1)(a)(i) is amended to integrate the instalment requirements for tax payable under Part I and new Part VI.1. This change is necessary because new Part VI.1 tax payable on dividends for a year may offset Part I tax payable on income for that year. The amendment will ensure that a corporation's Part I tax instalments for a year are not inappropriately reduced where Part VI.1 tax is payable for the year. Absent this change, in the first year Part VI.1 tax was payable by a corporation, it could estimate its Part I tax payable for the year after claiming a deduction under paragraph 110(1)(k) in computing its taxable income of 2 1/2 times its Part VI.1 tax payable for the year. As a result, the corporation's Part I tax instalments for the year might be reduced while its Part VI.1 tax instalments would be nil since it had no Part VI.1 payable for the preceding year.

An amendment to paragraph 157(1)(b) combines Part I and Part VI.1 tax for purposes of determining the remainder of tax payable by a corporation at the final tax payment date for a year. Consequential changes to Income Tax Regulation 5301 combine Part I tax and the new Part VI.1 tax for the purposes of determining the first and second instalment bases referred to in subparagraphs 157(1)(a)(ii) and (iii).

The amendments to paragraphs 157(1)(a) and (b) apply to the 1988 and subsequent taxation years.

Subclause 10(3)
ITA
157(2)

Subsection 157(2) of the Act is amended to provide that the relief from the instalment obligations for a year of a credit union with taxable income not exceeding $10,000 will apply only where it has no Part VI.1 tax for the year or the preceding year.

Subclause 10(4)
ITA
157(2.1)

Subsection 157(2.1) of the Act is amended to provide that the relief from the instalment provisions for a corporation with Part I tax payable or a first instalment base not exceeding $1,000 for a year be amended to add a reference to the corporation's Part VI.1 tax for the year.

Subclause 10(5)

This sets out the effective dates for the amendments to section 157 of the Act, all of which are applicable to the 1988 and subsequent taxation years.

Clause 11
Interest on Unpaid Taxes
ITA
161

Section 161 imposes interest on late or deficient instalment payments of tax or other amounts payable under the Act.

Subclause 11(1)
ITA
161(3)

Subsection 161(3) of the Act imposes an additional 3% interest on a credit union which did not pay instalments in a taxation year where it is subsequently found that the relief provided by subsection 157(2) was not available.

The amendment to subsection 161(3) is consequential on the amendment to subsection 157(2). By virtue of this amendment, the 3% additional interest will also be payable where a credit union has relied on subsection 157(2) in order not to pay instalments and it is subsequently found that it has Part VI.1 tax payable for the year. This amendment is applicable to the 1988 and subsequent taxation years.

Subclause 11(2)
ITA
161(4.1)(a)

Subsection 161(4.1) of the Act charges interest on the late or deficient instalments of a corporation based on its actual Part I tax payable for the year. Paragraph 161(4.1)(a) is amended to add a reference to the Part VI.1 tax payable by the corporation for the year. This change is consequential on the amendments to section 157 that integrate the instalment requirements for the taxes payable under Part I and new Part VI.1.

The amendment to paragraph 161(4.1)(a) is effective for the 1988 and subsequent taxation years. However, where the 1988 taxation year commences in 1987, interest on late or deficient instalments will be determined as if Part VI.1 tax were not payable by the corporation for the year. Therefore, no interest will be charged for a taxation year

commencing before 1988 if the payment of Part VI.1 tax is made on the final date on which the tax payment for the year becomes payable. In addition, for such year, the effect of the deduction under new paragraph 110(1)(k) on the computation of a corporation's Part I tax instalments is ignored.

Clause 12
Part IV

The purpose of Part IV of the Act is to prevent the deferral of tax by an individual on portfolio dividend income through the use of a private or closely-held corporation. While dividends received by individuals are subject to tax in their hands, corporations are generally permitted under section 112 to deduct dividends received in computing their taxable income. To counter the incentive for individuals to defer tax on their dividend income by transferring their portfolio shareholdings to a corporation, Part IV imposes a refundable tax on portfolio dividends received by private and other closely-held corporations. This tax is refunded to the corporation when taxable dividends are distributed to its shareholders since individual shareholders will then be subject to tax on the distribution.

Subclause 12(1)
ITA
186(1)(b)

Where a corporation that has paid tax under Part IV or has paid refundable taxes on other investment income subsequently pays taxable dividends, it is entitled to a refund of such taxes. Where such dividends are received by a connected corporation, paragraph 186(1)(b) imposes Part IV tax on the receipt of the dividend in an amount calculated by reference to the dividend refund in respect thereof obtained by the corporation that paid the dividend.

Subsection 112(2.4) and new subsection 112(2.2) of the Act apply in certain circumstances to deny the intercorporate dividend deduction in respect of dividends received by a corporation. Where this occurs Part IV tax should not apply since the corporation is fully taxed on these dividends under Part I of the Act. The amendment to paragraph 186(1)(b) excludes taxable dividends received from a connected corporation from the base on which Part IV tax is calculated in those circumstances where the dividend is not deductible under subsection 112(1) of the Act. A similar exclusion is provided in existing paragraph 186(1)(a) for non-deductible dividends received from a non-connected corporation. This amendment to paragraph 186(1)(b) is applicable to dividends received after June 18, 1987.

Subclause 12(2)
ITA
186(1.1)

New subsection 186(1.1) of the Act is consequential on the addition of new Part IV.1 which imposes a 10% tax on certain dividends received by certain corporations. The taxes under both Part IV and Part IV.1 can apply with respect to the same dividend received by a corporation. New subsection 186(1.1) provides that where a dividend is subject to tax under both Parts, the Part IV.1 tax payable on the dividend will be deducted from the Part IV tax otherwise payable on the same dividend. This amendment is applicable to dividends received after June 18, 1987.

Subclause 12(3)
ITA
186(6)

New subsection 186(6) of the Act sets out rules that clarify, for purposes of Part IV, the tax treatment of dividends received by partnerships for fiscal periods ending after June 18, 1987. These rules provide for the flow-through to partners of dividends received by a partnership. For the purposes of the Part IV tax, each partner is considered to own the same proportion of a corporation's shares that were owned by a partnership in a fiscal period as the proportion of the amount of the dividends received by the partnership that is included in the partner's income is of the dividends received by the partnership on such shares in that period. This amendment is applicable with respect to fiscal periods ending after June 18, 1987.

Subclauses 12(4) and (5)

These set out the effective dates for the amendments to section 186 of the Act.

Clause 13
Part IV.1

New Part IV.1 of the Act provides for two special taxes to be paid by certain corporations on dividends received by them after 1987 on a taxable preferred share or a taxable RFI share as those expressions are defined in subsection 248(1) of the Act.

Subclause 13(1)
ITA
187.1 and 187.2

New subsection 187.2 of the Act imposes a special 10% tax on dividends, other than excepted dividends, received by a corporation on a taxable preferred share other than a short-term preferred share or a share of a class subject to the special election provided in subsection 191.2(1). This tax applies with respect to dividends received after 1987, or deemed by subclause 13(2) to have been received after 1987, and must be paid by the corporation on or before the last day of the second month following the end of its taxation year. A taxable preferred share is defined in subsection 248(1) to include most preferred shares issued after 8:00 p.m. EDT, June 18, 1987.

The special 10% tax is payable on dividends on taxable preferred shares in respect of which the recipient corporation may claim an intercorporate dividend deduction under section 112 or 113 or under subsection 138(6) in computing its taxable income for the year other than dividends on short-term preferred shares or on taxable preferred shares where the corporation paying the dividends has made a special election in respect of the relevant class of shares under new subsection 191.2(1). Reference may be made to the commentary on that provision.

This special tax does not apply to excepted dividends. These are defined as

- dividends received by a corporation on a share of a foreign affiliate where the share was not acquired in the ordinary course of its business,

- dividends received by a corporation on a share of another corporation in which it has (or would have, if that other corporation were a taxable Canadian corporation) a substantial interest at the time the dividend was paid,

- dividends received by a corporation at a time when it was a private corporation, and

- dividends received by a corporation at a time when it was a financial intermediary corporation (this expression is defined in subsection 191(1) and reference may be made to the commentary on that provision).

For the purpose of this definition new subsection 191(2) applies to determine whether a corporation has a substantial interest in another corporation. Generally, a corporation is considered to have a substantial interest in another corporation if it is related to the other corporation or if it owns 25% or more, in terms of votes and value, of the shares of the other corporation.

Tax on dividends on taxable RFI shares
ITA
187.3

New subsection 187.3(1) of the Act levies a special 10% tax on dividends, other than excepted dividends, received by a restricted financial institution on a taxable RFI share that is acquired after 8:00 p.m. EDT, June 18, 1987. The tax applies to dividends received after 1987, or deemed by subclause 13(2) to have been received after 1987, in respect of which the institution may claim an intercorporate dividend deduction under subsection 138(6) or under section 112 or 113 in computing its taxable income for the year. The tax payable by an institution for a taxation year must be paid on or before the last day of the second month following the end of that year.

This special tax applies only to restricted financial institutions. The definition in subsection 248(1) of "restricted financial institution" includes a bank, trust company, credit union, insurance corporation, loan and mortgage company or a corporation controlled by one or more such corporations. A taxable RFI share is defined in subsection 248(1) to include most preferred shares that were issued before 8:00 p.m. EDT, June 18, 1987 that are not term preferred shares. However, an important exception in the taxable RFI share definition will permit a restricted financial institution to be exempted from the 10% tax on dividends received on shares acquired before December 15, 1987 that would otherwise be taxable RFI shares provided it does not acquire shares in excess of certain threshold amounts. Reference may be made to the commentary under the definition of taxable RFI shares.

The 10% tax is not payable by a restricted financial institution on an "excepted dividend" as that expression is defined in section 187.1. Reference may be made to the commentary on that provision.

New subsection 187.3(2) of the Act contains a number of grandfathering provisions with respect to the acquisition of taxable RFI shares after 8:00 p.m. EDT, June 18, 1987. This subsection treats a share that is acquired by a person or partnership after 8:00 p.m. EDT, June 18, 1987 as having been acquired before that time and thus not subject to the new tax under section 187.3, where

- the share was acquired pursuant to an agreement in writing entered into before that time;

- the share was acquired as part of a distribution to the public made in accordance with the terms certain documents filed with a public authority before that time;

- the share was acquired on the conversion of a share or debt obligation issued before that time and its terms and conditions were established in writing before that time;

- the share is a share of a Canadian corporation listed on a stock exchange in Canada and was acquired on the exercise of a right, such as a warrant, that was similarly listed and the terms and conditions of the share were established in writing before that time; or

- the share was acquired from a related person in the circumstances outlined in new paragraph 187.3(2)(e).

Partnerships
ITA
187.4

New section 187.4 of the Act sets out rules that clarify for the purposes of new Part IV.1 the tax treatment of dividends received by partnerships after 1987. These rules provide for the flow-through to partners of dividends received by a partnership. Each partner is considered to own a proportion of the shares that were owned by the partnership in a fiscal period based on the proportion of the dividends received by the partnership on such shares in the period that is included in computing the partner's income. They also provide that a reference to a person in Part IV.1 includes a partnership.

Information return
ITA
187.5

New section 187.5 of the Act requires a corporation, liable for tax under new Part IV.1 for a taxation year, to file a return in prescribed form containing an estimate of its tax payable under sections 187.2 and 187.3 for the year.

Provisions applicable to Part
ITA
187.6

New section 187.6 of the Act provides that certain provisions of Part I relating to assessments, penalties, objections and appeals are applicable for the purposes of the taxes payable under Part IV.1.

Subclause 13(2)

Subclause 13(2) provides that the new Part IV.1 tax is applicable with respect to dividends received after 1987. It also treats dividends received after December 15, 1987, but before 1988, as having been received on January 1, 1988 where it may reasonably be considered that these dividends were paid at that time to avoid or limit the application of the new Part IV.1.

Clause 14
Part VI.1

New Part VI.1 of the Act provides for a special tax to be paid with respect to dividends, other than excluded dividends, paid by corporations after 1987 on taxable preferred shares. The purpose of this tax is to make the tax system more neutral as between debt and preferred share financing. The Part VI.1 tax may be offset against tax payable under Part I of the Act by way of a deduction provided by new paragraph 110(1)(k) so that the overall tax liability for those corporations with Part I tax payable will remain largely unaffected by the Part VI.1 tax. As explained below, a $500,000 annual dividend allowance will exempt from the tax dividends on preferred shares paid by most small corporations.

Definitions
ITA
191(1)

New subsection 191(1) defines certain expressions used in new Part VI.1.

Excluded dividends on taxable preferred shares are not subject to the Part VI.1 tax. The term excluded dividends means:

- dividends paid to a shareholder who had a substantial interest in the payer corporation when the dividend was paid,

- dividends paid by a corporation that was a financial intermediary corporation or a private holding corporation when the dividend was paid;

- dividends paid by a corporation that would, under certain conditions, have been a financial intermediary corporation.

Dividends paid by a financial intermediary corporation are not subject to Part VI.1 tax. The expression "financial intermediary corporation", also used in new Part IV.1, includes:

- a corporation licensed to issue investment contracts, as described in clause 146(1)(j)(ii)(B);

- an investment corporation;

- a mortgage investment corporation;

- a mutual fund corporation;

- a prescribed venture capital corporation, or

- a prescribed labour-sponsored venture capital corporation.

Such a corporation will not be a financial intermediary corporation, however, if it is a prescribed corporation, or a corporation

- that is controlled in any manner whatever by one or more corporations that are not financial intermediary corporations or private holding corporations, except where such controlling corporations do not own more than 10%, in value, of all the issued and outstanding shares of the corporation, or

- in which a corporation (except a financial intermediary corporation or a private holding corporation) has a substantial interest.

Part VI.1 also does not apply to dividends paid by a private holding corporation. The expression "private holding corporation" is defined as a corporation that does not own shares of another corporation (except another private holding corporation) in which it has a substantial interest and the only undertaking of which is the investment of its funds. Such a corporation will not be a private holding corporation, however, if it is a specified financial institution (as defined in subsection 248(1)) or a corporation that is controlled in any manner whatever by one or more corporations other than private holding corporations, or in which a corporate shareholder other than a private holding corporation has a substantial interest.

Substantial interest
ITA
191(2) and (3)

New subsection 191(2) of the Act describes the circumstances in which a shareholder will be treated as having a substantial interest in a corporation. A shareholder has a substantial interest in a corporation where the shareholder is related to the corporation (otherwise than by reason of a right referred to in paragraph 251(5)(b)) or where the shareholder owns shares of that corporation representing, in terms of votes and value, 25% or more of its issued shares and, as well, common shares representing at least 25% of the fair market value of all common shares. For the purpose of subsection 191(2) shares owned by persons related to a shareholder are considered to be owned by the shareholder.

New subsection 191(3) deems a shareholder of a corporation not to have a substantial interest in another corporation where

- it is reasonable to consider that the principal purpose for acquiring the interest in the other corporation was to avoid or limit the application of Part IV.1 or VI.1,

- the shareholder is a financial intermediary corporation that is not related to the corporation, or

- the shareholder is a partnership or trust except a trust in which the beneficiaries are related to each other.

Reorganizations
ITA
191(4) and (5)

New subsections 191(4) and (5) of the Act provide that the new Part IV.1 tax and tax payable under section 187.2 do not apply with respect to certain deemed dividends arising in the course of corporate reorganizations.

Subsection 84(3) of the Act provides that where a corporation resident in Canada has paid an amount on the redemption, acquisition or cancellation of a share of its capital stock, a dividend equal to the excess of the amount paid over the paid-up capital of the share is deemed to have been paid by the corporation and received by the shareholder. Subsection 84(2) provides a similar rule with respect to amounts distributed or otherwise appropriated on the winding-up, discontinuance or reorganization of the business of a corporation.

New subsection 191(4) applies with respect to a deemed dividend arising under subsections 84(2) and (3) of the Act on the redemption, acquisition or cancellation of a share that was issued in the course of a reorganization in the circumstances described in paragraphs 191(4)(a), (b) and (c). For example, this subsection would apply to shares issued pursuant to certain estate freezing arrangements. Since they are usually retractable, shares issued pursuant to these arrangements often constitute taxable preferred shares. Subsection 191(4) provides that the new Part VI.1 tax and the new Part IV.1 tax applicable to dividends paid on taxable preferred shares will not apply to the deemed dividends arising on the redemption, acquisition or cancellation of these shares. This exception, however, does not apply with respect to that part of any deemed dividends that is attributable to the payment of an amount in excess of the value of the share at the time it was issued.

The last part of subsection 191(4) extends that exception to certain deemed dividends arising in the course of a reorganization described in paragraph 55(3)(b) of the Act. That paragraph permits, as part of what is generally referred to as a "butterfly" reorganization, the distribution of assets by a corporation to its shareholders on a tax-deferred basis. Where a share is issued for property of a corporation in the course of such reorganization, it is deemed not to have been issued for the purpose of raising capital, so that it will not be excluded from the application of subsection 191(4) by paragraph (b) thereof.

New subsection 191(5) also provides an exception from the new Part VI.1 tax and the tax payable under section 187.2 for dividends paid on taxable preferred shares in circumstances where a deemed dividend arises under subsection 84(3) on the redemption, acquisition or cancellation of a share. This exception applies where the terms and conditions of a share are changed or an agreement in respect of that share is changed or entered into so that this share becomes a taxable preferred share and that share is subsequently redeemed, acquired or cancelled not later than one year afterwards. This rule would apply, for example, where, as a result of a buy-out agreement, a share that is otherwise a common share must be redeemed within twelve months of the agreement. The exception provided by subsection 191(5), however, does not apply with respect to that part of the deemed dividend arising on a share that is attributable to the payment of an amount in excess of the fair market value of the share at the time its terms or conditions were changed or the agreement in respect of the share was changed or entered into.

Tax payable
ITA
191.1(1)

New subsection 191.1(1) of the Act provides for a tax to be paid by a corporation that has paid taxable dividends on taxable preferred shares. This tax applies to dividends, other than excluded dividends, paid after 1987, or deemed by subclause 14(3) to have been paid after 1987. The tax is payable by way of monthly instalments, as provided by amended subparagraph 157(1)(a)(i). Reference may be made to the commentary on that provision.

The tax to be paid under paragraph 191.1(1)(a) is equal to 66 2/3% of the amount by which the taxable dividends (other than excluded dividends) paid by the corporation in the year on short-term preferred shares exceed the corporation's dividend allowance for the year. As discussed in the commentary on the definition of short-term preferred share in subsection 248(1), short-term preferred shares are shares which are retractable or could be required to be redeemed within 5 years. Since short-term preferred shares may be considered to be debt-substitutes, the rate of 66 2/3% is intended to approximate the amount of tax that may be paid on an equivalent amount of interest assuming a 40% rate of corporate tax.

Where taxable dividends are paid by a corporation on its taxable preferred shares (defined in subsection 248(1) to include most preferred shares), other than short-term preferred shares, and in respect of which no election has been made under section 191.2, the tax to be paid is equal to 25% of the amount by which these taxable dividends exceed the corporation's dividend allowance for the year.

Where the corporation has made an election under subsection 191.1(2) in respect of a class of its taxable preferred shares, the rate of this tax will be 40%. Reference should be made to the commentary on subsection 191.2(1) relating to this election.

A parent corporation and its subsidiary may agree under subsection 191.3(1) that the subsidiary will pay any Part VI.1 tax otherwise payable by the parent corporation. The purpose of this provision is described in the commentary on that subsection. Where such an agreement is made, the agreed amount will be added to the Part VI.1 tax payable by the subsidiary and will reduce the Part VI.1 tax payable by the parent.

New Part VI.1 tax is not payable in respect of excluded dividends as defined in subsection 191(1). These are dividends paid to a shareholder who had a substantial interest in the payer corporation when the dividend was paid, dividends paid by a corporation that

was a financial intermediary corporation or a private holding corporation when the dividend was paid and dividends paid to certain shareholders by a corporation that would, under certain conditions; have been a financial intermediary corporation.

The Part VI.1 tax is payable only in respect of dividends (other than excluded dividends) paid on taxable preferred shares by the corporation in excess of its dividend allowance for the year. As explained in the commentary under subsection 191.1(2), the dividend allowance for a taxation year of a corporation or corporate group is $500,000 less the amount of non-excluded dividends paid in the preceding calendar year in excess of $1,000,000.

Dividend allowance
ITA
191.1(2) to (6)

A corporation will generally pay tax under Part VI.1 only on dividends on taxable preferred shares (other than excluded dividends) paid by it in excess of its dividend allowance. New subsections 191.1(2) to (6) of the Act set out the rules applicable for the computation of a corporation's dividend allowance. These rules parallel the rules used in determining a corporation's business limit for the purposes of the small business deduction under section 125.

New subsection 191.1(2) determines a corporation's dividend allowance for a taxation year to be $500,000 where the corporation is not associated with another corporation in the year. This amount, however, is subject to a clawback that reduces it on a dollar-for-dollar basis by the amount of non-excluded dividends in excess of $1,000,000 paid in the preceding calendar year by the corporation on its taxable preferred shares or shares that would have been taxable preferred shares if they had been issued after June 18, 1987.

New subsections 191.1(3), (4) and (5) of the Act apply for the purpose of determining the dividend allowance of associated corporations. A total dividend allowance is first determined for a group of associated taxable Canadian corporations. Under subsection 191.1(4), this total dividend allowance is $500,000 less the excess over $1,000,000 of non-excluded dividends paid in the preceding calendar year by the corporations in that group on taxable preferred shares or shares that would have been taxable preferred shares if they had been issued after June 18, 1987. These corporations may then allocate the total dividend allowance among the group by filing a prescribed agreement under new subsection 191.1(3)

of the Act. If such agreement is not filed by any corporation in the group that has paid dividends on taxable preferred shares in the year, the Minister of National Revenue may make the allocation under new subsection 191.1(5).

New paragraph 191.1(6)(a) of the Act applies to all corporations, whether or not associated, and requires a proration of the dividend allowance for any taxation year of less than 51 weeks duration. It provides that a corporation's dividend allowance for a short taxation year is its dividend allowance otherwise determined multiplied by the number of days in the year and divided by 365.

New paragraph 191.1(6)(b) of the Act is applicable where a corporation has two or more taxation years ending in the same calendar year in which it is associated with another corporation. This rule provides that the corporation's dividend allowance (before proration for the short year) for each such taxation year is the amount allocated to it for its first such taxation year under subsection 191.1(3). The corporation's dividend allowance for each such year is then determined after the required proration pursuant to new paragraph 191.1(6)(a).

Election
ITA
191.2

The rate of Part VI.1 tax on dividends paid on taxable preferred shares (other than short-term preferred shares) of a class in respect of which a corporation has made an election under new section 191.2 is 40% instead of 25%. The effect of the election to pay the 40% is to enable shareholder corporations to receive dividends without being subject to the 10% tax under Part IV.1.

An election may be made by a taxable Canadian corporation in respect of a class of its taxable preferred shares only if the terms and conditions applicable to the shares require that this election be made. According to new section 191.2, the election is to be made by filing a prescribed form with the Minister of National Revenue not later than the day on or before which a return of income must be filed by the corporation under Part I for the taxation year in which shares of that particular class of shares are first issued or first become a taxable preferred share. A special transitional rule is provided in subclause 13(4) to allow elections to be filed at any time within 6 months from the date on which the implementing legislation receives Royal Assent.

Agreement respecting liability for tax
ITA
191.3

New section 191.3 of the Act allows a corporation that is liable to pay tax under Part VI.1 in a taxation year and a corporation controlled by it to file an agreement whereby all or a portion of the Part VI.1 tax liability is transferred to the controlled corporation. This will prove advantageous to holding corporations that do not pay Part I tax against which they can offset the Part VI.1 tax through the special deduction provided by paragraph 110(1)(k).

This agreement may be made only where a corporation (the parent corporation) controls another corporation throughout its taxation year and throughout the last taxation year of that other corporation.

Under new subsection 191.3(2) an agreement or amended agreement must be filed by the parent corporation and the controlled corporation with the Minister of National Revenue in prescribed form no later than the day on which the parent corporation's tax return under Part I is required to be filed for its taxation year in which Part VI.1 tax would otherwise be payable by it. An agreement or amended agreement may also be filed within 90 days of the day of mailing of a notice of assessment (or notification that no tax is payable) to the parent corporation or the controlled corporation. Subsection 191.3(2) also requires the agreement to be accompanied by a certified copy of a resolution of the directors (or the persons legally entitled to administer the affairs of the corporation) of both the parent and controlled corporation authorizing such an election.

New subsection 191.3(3) imposes on the Minister of National Revenue the duty to assess the parent and controlled corporations according to such an agreement or amended agreement even where the three-year limit provided by subsections 152(4) and (5) might otherwise apply.

New subsection 191.3(4) is an anti-avoidance provision that prevents a corporation from acquiring the control of another corporation which has accrued gains in order to transfer its Part VI.1 tax liability to the acquired corporation through a subsection 191.3(1) election. Absent such a rule, this election would allow the corporation to effectively avoid the payment of the Part VI.1 tax since the deduction allowed by subsection 110(1)(k) would allow the acquired corporation to offset the Part VI.1 tax so transferred against its Part I tax payable on the realization of its accrued gains.

As a result of an agreement made under subsection 191.3(1), the amount of tax specified in the agreement will be included in the Part VI.1 tax payable by the controlled corporation and will be

deducted from the amount of Part VI.1 tax otherwise payable by the parent corporation. Both corporations remain jointly and severally liable to pay the tax and the interest and penalties in respect thereof. Thus, new subsection 191.3(5) permits the Minister to assess the parent corporation in respect of the agreed amount of tax and provides that certain provisions of Part I relating to assessments, penalties, objections and appeals are then applicable.

New subsection 191.3(6) provides that where payment is made by the parent corporation on account of this joint liability, the joint liability is reduced accordingly. However, any payment by the controlled corporation will reduce the parent corporation's liability only to the extent of the excess, if any, of the amount paid over what is the controlled corporation's remaining liability under the Act after the payment. In effect, this treats a tax payment by the controlled corporation as applying first against its other tax liabilities under the Act.

Information return
ITA
191.4

New subsection 191.4(1) of the Act requires a corporation liable for any tax under new Part VI.1 for a taxation year to file a return containing an estimate of its tax payable for the year. The return is to be filed on or before the date by which its Part I corporate tax return is required to be filed.

New subsection 191.4(2) of the Act provides that certain provisions of Part I relating to assessments, penalties, objections and appeals are applicable to the tax under Part VI.1.

Subclauses 14(2) to (4)

The Part VI.1 tax is applicable to the 1988 and subsequent taxation years but only with respect to dividends paid after 1987. For that purpose, subclause 14(3) provides that dividends received after December 15, 1987, but before 1988, are treated as having been paid on January 1, 1988 where it may reasonably be considered that these dividends were paid at that time to avoid or limit the application of the new Part VI.1.

A special provision applies with respect to elections under new subsection 191.2 of the Act. Since, in some cases, such elections may be required to be filed before the enactment of new subsection 191.2, subclause 14(4) provides that an election will be deemed to have been filed on time if it is filed within 6 months of the date on which the implementing legislation receives Royal Assent.

Clause 15
Application to other Parts
ITA
227(14)

Subsection 227(14) of the Act provides that a corporation is not liable to tax under Part III, IV or VI of the Act for any period of time during which it was exempt from Part I tax by reason of section 149 of the Act. This provision is amended effective for the 1988 and subsequent taxation years as a consequence of the introduction of new Parts IV.1 and VI.1 to provide that those new Parts do not apply to any corporation for any period throughout which it is tax-exempt under section 149.

Clause 16
Definitions
ITA
248(1)

Subsection 248(1) of the Act defines many of the terms used in the Act.

Subclause 16(1)
"Short-term preferred share"

The definition "short-term preferred share" is to be amended with respect to shares issued after 8:00 p.m. EDT, June 18, 1987.

Under existing subsection 112(2.3) of the Act dividends received by a corporation on a short-term preferred share are not deductible in computing its taxable income unless the corporation does not deal at arm's length with the dividend-paying corporation. In general, a share which was issued in lieu of commercial paper or short-term debt and that may be retracted within 18 months of its issue falls within the existing definition short-term preferred share.

Subsection 112(2.3) is repealed with respect to dividends paid on short-term preferred shares issued after 8:00 p.m. EDT, June 18, 1987. Dividends paid on such shares (other than grandfathered shares) issued after that time will be subject to a 66 2/3% special tax provided by new Part VI.1.

The amended definition of short-term preferred share generally applies to shares issued after 8:00 p.m. EDT, June 18, 1987. The condition that the share be issued in lieu of commercial paper or short-term debt is no longer included in the definition. In addition, under paragraph (a), the 18-month retraction period is extended so that a

share will be a short-term preferred share if the issuing corporation or a specified person in relation to the issuer may under the terms of the share or an agreement in respect of the share be required to redeem, acquire or cancel the share or to reduce its paid-up capital within 5 years of the date of issue. A share will not be a short-term preferred share under paragraph (a) if the requirement to redeem, acquire or cancel the share arises solely in the event of the death of the shareholder or on a conversion or exchange of the share.

Paragraph (b) of the new definition provides that a short-term preferred share also includes a share that is convertible or exchangeable within 5 years from the date of its issue except in those circumstances where the share of a corporation is convertible or exchangeable only into a share of the corporation or a specified person in relation to the corporation that if issued would not be a short-term preferred share, or into a right or warrant to acquire such a share that is not a short-term preferred share, and all the consideration receivable upon the conversion or exchange is the share, right, warrant or a combination thereof.

Paragraphs (c) to (j) of the new definition provide a number of supplementary rules.

The amended definition of short-term preferred share applies only to shares issued after 8:00 p.m. EDT, June 18, 1987. However, where the terms or conditions of a share (or any agreement in respect of that share) relating to the share's redemption, acquisition, cancellation, conversion or reduction of its paid-up capital, are established or changed after that time, paragraph (c) will treat the share as having been issued at that later time.

Paragraph (d) is similar to paragraph (h) of the existing short-term preferred share definition. This paragraph anticipates the possibility that a share may be issued in combination with a debt obligation or another short-term preferred share in order to circumvent the new Part VI.1 tax. Where one of the main purposes of the issue of the share or modification of its terms and conditions is to avoid or limit the taxes payable under new Part VI.1, this paragraph treats the share as a short-term preferred share.

Paragraph (e) treats a share as a short-term preferred share if, after 8:00 p.m. EDT, June 18, 1987, the terms of the share are established or modified or any agreement in respect of the share has been changed or entered into so that it is reasonable to expect that the share will be redeemed within 5 years of its date of issue. This might apply, for example, in the case of a redeemable share issued for an indefinite term but on which the rate of dividends or redemption

premium is scheduled to increase sharply at some time within 5 years from its date of issue. In this case the share could reasonably be expected to be redeemed before any such increase would take effect.

Paragraph (f) treats a share as a short-term preferred share in circumstances where the issuing corporation will dissolve or wind-up within 5 years from the date on which the share was issued.

Paragraph (g) applies where a share issued by a corporation is originally acquired by a specified person in relation to the corporation and is subsequently acquired by an arm's length party. In this situation, for the purposes of the 5-year test, the share is treated as having been issued at the time of the subsequent acquisition.

Paragraph (h) of the definition will treat a share as a short-term preferred share where any person (other than the issuing corporation or an individual) has undertaken in an agreement to which the issuing corporation or a specified person in relation thereto is a party to guarantee all or part of the shareholder's investment against any loss that he may suffer within 5 years of the issuance or acquisition issue of the share. For the purpose of this rule, the share is treated as having been issued at the time the guarantee agreement is given.

Paragraph (i) excludes from the definition of short-term preferred share a prescribed share and a share issued by a corporation in financial difficulty (described in paragraph (e) of the definition "term preferred share").

Paragraph (j) provides that the expression specified person has the meaning assigned to it by paragraph (h) of the definition of taxable preferred share and means any person with whom the corporation does not deal at arm's length or any partnership or trust of which the corporation or any such other person is a member or beneficiary.

The new definition of short-term preferred share applies with respect to shares issued or deemed to have been issued after 8:00 p.m. EDT, June 18, 1987.

Subclause 16(2)
"Grandfathered share"

This amendment adds the definition "grandfathered share" to subsection 248(1) of the Act. Grandfathered shares are expressly excluded from the application of new subsection 112(2.2) and from the definitions of short-term preferred share and taxable preferred share in subsection 248(1). Under this definition a share is a grandfathered share if it is issued after 8:00 p.m. EDT, June 18, 1987 and it

- was issued pursuant to an agreement in writing entered into before that time;

- was issued as part of a distribution to the public made in accordance with certain documents filed with a public authority before that time;

- was issued on the conversion of a grandfathered share or of a share or debt obligation issued before that time where the terms and conditions of that share were established in writing before that time; or

- is a share of a Canadian corporation listed on a stock exchange in Canada and was issued on the exercise of a right or warrant that was similarly listed where the terms and conditions of that share were established in writing before that time.

However, a share ceases to be a grandfathered share if it is deemed to have been issued at any time after June 18, 1987 under subsection 112(2.2) or under the definition of "short-term preferred share" or "taxable preferred share".

"Restricted financial institution"

This amendment adds the definition "restricted financial institution" to subsection 248(1) of the Act. This definition is used for the purpose of the new Part IV.1 tax on taxable RFI shares. A restricted financial institution includes a bank, trust company, credit union, insurance corporation, loan and mortgage company or a corporation controlled by one or more such corporations. Unlike the definition of "specified financial institution", however, this definition does not include a corporation which is associated with, but not controlled by, one or more of the financial institutions listed above.

"Specified financial institution"

This amendment adds the definition "specified financial institution" to subsection 248(1) of the Act. The status of a taxpayer as a specified financial institution is relevant for the purposes of subsections 112(2.1) and (2.2), new Parts IV.1 and VI.1 and certain other provisions of the Act. A specified financial institution includes a bank, trust company, credit union, insurance corporation, loan and mortgage company or a corporation controlled by or associated with one or more such corporations. This definition is unchanged from that provided under existing subsection 112(2.1) of the Act.

"Taxable preferred share"

This amendment adds the definition "taxable preferred share" to subsection 248(1) of the Act.

This definition is relevant for the purposes the taxes imposed under new Parts IV.1 and VI.1 of the Act.

This definition includes a share that is a short-term preferred share under the definition of that expression. It also includes any share (other than a grandfathered share) that is issued after 8:00 p.m. EDT, June 18, 1987 where:

(a) it may reasonably be considered that the amount of any dividend on that share is fixed, limited to a maximum or established to be not less than a minimum,

(b) it may reasonably be considered that the amount that a shareholder is entitled to receive for the share upon the dissolution, liquidation or winding-up of the issuing corporation, or on the redemption, acquisition or cancellation of the share is fixed, limited to a maximum or established to be not less than a minimum,

(c) the share is convertible or exchangeable except in those circumstances where the share is convertible or exchangeable only into a share of the corporation or a specified person in relation thereto that if issued would not be a taxable preferred share or a right or warrant to acquire such a share, and all the consideration receivable upon the conversion or exchange is the share, right, warrant or combination thereof, or

(d) any person, other than the issuing corporation, has undertaken (in an agreement with the issuing corporation or a person related to it) to guarantee the shareholder's investment in the share (for the purpose of this condition where such a guarantee agreement is given after 8:00 p.m. EDT, June 18, 1987 in respect of a share, the share is deemed to have been issued at that time).

Excluded from this definition are prescribed shares or shares issued by a corporation in financial difficulty (described in paragraph (e) of the definition "term preferred share").

Paragraphs (c) to (h) of the definition provide a number of supplementary rules.

Paragraphs (c) and (d) of the definition treat a shareholder's entitlement to dividends or an amount on liquidation of the issuing corporation as not being fixed, limited to a maximum or established

not to be less than a minimum where such entitlement is determined by reference to the entitlement of another share of the corporation or of another corporation that controls the corporation, provided the other share would not be a taxable preferred share if this definition were read without reference to paragraph (f), the other share were issued after June 18, 1987, and the other share were not a grandfathered share, a prescribed share or a share issued by a corporation in financial difficulty.

As noted above, the definition of taxable preferred share applies only where the share was issued after 8:00 p.m. EDT, June 18, 1987. Where the terms or conditions of a share issued before that time are changed or an agreement in respect of that share is changed or entered into so as to affect any of the matters referred to subparagraphs (b)(i) to (iv), paragraph (e) will treat the share as having been issued at the time of the change for the purposes of determining whether the share is a taxable preferred share.

Paragraph (f) is a relieving provision that provides that the liquidation entitlement of a shareholder shall not be considered to be fixed, limited to a maximum or established to be not less than a minimum, solely as a result of an agreement to which the corporation or a specified person with respect to the corporation is a party, such as a shareholders agreement, providing that a purchaser agrees to acquire the share at an amount approximating its fair market value at the time of the acquisition.

Paragraph (g) is an anti-avoidance rule that prevents the use of holding corporations to avoid the new Part IV.1 and VI.1 taxes. This rule deems a share to be a taxable preferred share where:

- the share is not a grandfathered share and has been issued after December 15, 1987,

- the dividends on that share may reasonably be considered to be derived primarily from dividends on taxable preferred shares of a corporation in which the issuing corporation has a substantial interest, and

- the share was issued or acquired to avoid the application of new Parts IV.1 and VI.1.

Paragraph (h) provides that the expression "specified person" used throughout the definition means any person with whom the corporation does not deal at arm's length or any partnership or trust of which the corporation or the other person is a member or beneficiary.

The amended definition of taxable preferred share applies with respect to shares issued, or deemed to be issued, after 8:00 p.m. EDT, June 18, 1987.

"Taxable RFI share"

This amendment adds the definition "taxable RFI share" to subsection 248(1) of the Act.

New section 187.3 of the Act imposes a tax of 10% on dividends received by restricted financial institutions on taxable RFI shares acquired after 8:00 p.m. EDT, June 18, 1987.

A taxable RFI share is a share issued before 8:00 p.m. EDT, June 18, 1987 or a grandfathered share where

(a) it may reasonably be considered that the amount of any dividend on that share is either fixed, limited to a maximum or established to be not less than a minimum, or

(b) it may reasonably be considered that the amount that a shareholder is entitled to receive for the share upon the dissolution, liquidation or winding-up of the issuing corporation, or on the redemption, acquisition or cancellation of the share is fixed, limited to a maximum or established to be not less than a minimum.

Excluded from the definition are shares which are prescribed shares, term preferred shares or shares issued by a corporation in financial difficulty as described in paragraph (e) of the definition "term preferred share".

Paragraphs (c) and (d) of the definition treat a shareholder's entitlement to dividends or an amount on liquidation of the issuing corporation as not being fixed, limited to a maximum or established to be not less than a minimum where such entitlement is determined by reference to the entitlement of another share of the corporation or of another corporation that controls the corporation provided the other share would not be a taxable preferred share if that definition were read without reference to paragraph (f), the share were issued after June 18, 1987, and the share were not a grandfathered share, a prescribed share or a share issued by a corporation in financial difficulty.

Paragraph (e) of the definition is an anti-avoidance provision that applies where it may be reasonably be considered that the dividends on a particular share are derived primarily from dividends received on taxable RFI shares of another corporation and that the particular

share was issued or acquired in order to avoid or limit the application of new Part IV.1. Where this is the case, the particular share will be treated as a taxable RFI share and the shareholder who receives dividends on such a share will be deemed not to have a substantial interest in the paying corporation.

Since taxable RFI shares cannot by definition be term preferred shares, restricted financial institutions holding such shares are generally entitled to the intercorporate dividend deduction under subsection 112(1) for dividends received on such shares. Subsection 187.3(1) imposes a 10% tax on dividends received after 1987 on taxable RFI shares acquired after 8:00 p.m. EDT, June 18, 1987 other than shares deemed to have been acquired before that date under subsection 187.3(2) (see commentary on that provision).

The definition of taxable RFI shares provides an exclusion for prescribed shares. For this purpose Regulation 6201(4) prescribes certain shares acquired before December 16, 1987 not to be taxable RFI shares. Under that regulation a share of a class of the capital stock of a corporation acquired before that date will be a prescribed share at the time a dividend is received with respect to a corporation holding the share if the aggregate holdings of the corporation and restricted financial institutions with which the corporation does not deal at arm's length in shares of that class at that time does not exceed 10% of the issued shares of that class.

Taxable RFI shares acquired after December 15, 1987 will not be prescribed.

The rule in Regulation 6201(5) provides that shares disposed of will be considered to be disposed of on a last-in, first-out basis.

The definition of taxable RFI share is applicable after June 18, 1987.

Subclause 16(3)
"Amount"

The amendment to the definition "amount" in subsection 248(1) of the Act is consequential on the addition of new Part IV.1 and VI.1 to the Act relating to taxable preferred shares. The amendment adds to this definition a reference to sections 187.2, 187.3, 191.1 and subsections 258(3) and (5) for the purpose of determining the amount of a stock dividend. Thus, for the purposes of the Act, where the new Part IV.1 taxes or the special rules that deny the intercorporate dividend deduction in respect of certain shares apply with respect to a stock dividend paid by a corporation, the amount of the stock

dividend will be the greater of the amount of the resultant increase in the corporation's paid-up capital and the fair market value of the shares paid as a stock dividend at the time of payment. However, where the new Part VI.1 tax provided by section 191.1 applies with respect to a stock dividend, the same rule will apply only for the purposes of Part VI.1. This amendment is applicable with respect to dividends paid after June 18, 1987.

Subclauses 16(4) to (7)

"Term preferred share"

Paragraph (e) of the definition "term preferred share" in subsection 248(1) of the Act excludes shares issued by a corporation in financial difficulty. The amendment to subparagraph (e)(iii) of the definition, applicable to shares issued after 8:00 p.m. EDT, June 18, 1987 clarifies that if a corporation is, or is expected to be, in default on a debt obligation and a share is issued in exchange for the obligation, the share will be excluded from the definition only if all or substantially all of the share issue proceeds are used to repay all or part of the debt.

New paragraph (f.1) will exclude from this definition a taxable preferred share acquired before December 16, 1987 if this share has been issued between June 18, 1987 and December 16, 1987 (provided such shares are not deemed to have been issued after December 15, 1987 by reason of a change of their terms or conditions or by reason of an agreement being changed or being entered into). The draft legislation released on June 18, 1987 excluded taxable preferred shares from the definition of term preferred share. Taxable preferred shares issued after December 15, 1987 are not excluded from the definition "term preferred share" unless they are acquired after December 15, 1987 and before 1989 pursuant to an agreement in writing entered into before December 16, 1987. Shares acquired before December 16, 1987 are similarly grandfathered. This amendment is applicable after June 18, 1987.

Regulation 6201 prescribes shares for the purpose of the exclusion in paragraph (f) of this definition. Under that regulation a publicly-listed share issued after 8:00 p.m. EDT, June 18, 1987 will not be a term preferred share where the recipient of a dividend on the share and specified persons in relation to that recipient receive dividends in respect of not more than 10% of the issued and outstanding shares of the class (that share may, however, be a taxable preferred share). In the case of a publicly-listed share issued before 8:00 p.m. EDT June 18, 1987 or a grandfathered share, a distinction is made on the basis of the date of acquisition. Where

the share is acquired before December 16, 1987, it will not be a term preferred share where the recipient of a dividend on this share and specified persons in relation to that recipient receive dividends in respect of not more than 10% of the issued and outstanding shares of that class. Such a share acquired after December 15, 1987, will also be excluded from the definition of term preferred share subject to the same 10% limit but only with respect to a shareholder that is a not a restricted financial institution.

New paragraph (i.1) clarifies that a share will not fall within the definition of term preferred share solely because of an agreement under which the corporation or a specified person in relation to the corporation agrees to acquire the share for its fair market value determined without regard to the agreement or to acquire that share in exchange for a share that is not a term preferred share. This amendment is applicable after June 18, 1987.

Paragraph (i.2) is an anti-avoidance provision that applies where it may be reasonably be considered that the dividends on a particular share are derived primarily from dividends received on term preferred shares of another corporation and that the share was issued or acquired in order to avoid or limit the application of subsection 112(2.1) of the Act. Where this is the case, the particular share will be treated as a term preferred share acquired in the ordinary course of business.

As noted above, the definition of term preferred share will not apply with respect to a taxable preferred share issued before December 16, 1987. Where the terms or conditions of a share issued before that time are changed or an agreement in respect of that share is changed or entered into so as to affect any of the matters referred to subparagraphs (a)(i) to (iv) of this definition, new paragraph (i.3) will treat the share as having been issued at the time of the change. This amendment is applicable after June 18, 1987.

The further amendment introduced by subclause (7) to the definition "term preferred share" deletes the rule relating to interests in trusts. This change is strictly consequential on the addition of new subsection 248(12) dealing with interests in trusts and partnerships. This amendment is applicable to shares issued after 8:00 p.m. EDT, June 18, 1987.

Subclause 16(8)
ITA
248(6)

Subsection 248(6) of the Act extends all references to a class of shares to a series of the class of shares. The amendment to that subsection clarifies that this rule also applies where a single series of a class of shares has been issued.

Subclause 16(9)
ITA
248(12)

New subsection 248(12) of the Act treats a person having a direct or indirect interest in a trust or partnership as being a beneficiary or member, as the case may be, of that trust or partnership for the purposes of a number of definitions and rules in the Act.

Subclauses 16(10) to (13)

These subclauses set out the effective dates for the amendments to section 248 of the Act.

Clause 17
Control Deemed not to be acquired
ITA
256(7)

Subsection 256(7) of the Act describes those circumstances where control of a corporation is considered not to have been acquired for the purposes of certain provisions of the Act. The amendment to this subsection extends the application of that provision to subsection 191.3(4) which is an anti-avoidance provision applicable with respect to agreements to transfer Part VI.1 tax to a subsidiary.

This amendment is applicable to acquisitions of control occurring after 8:00 p.m. EDT, June 18, 1987.

Clause 18
Dividends on certain shares
ITA
258

Special rules are provided under the Act to disallow the intercorporate dividend deduction in respect of dividends paid on certain shares and income bonds or debentures. Section 258 complements these rules.

Subclause 18(1)
ITA
258(1)

Subsection 258(1) of the Act provides special rules for deemed dividends on term preferred shares. This provision is repealed as a consequence of the introduction of new subsection 84(4.2) to which these rules have been transferred (see commentary on that provision). This amendment is applicable with respect to reductions of paid-up capital after 1987.

Subclause 18(2)
ITA
258(3)

Subsection 258(3) of the Act treats certain dividends received on shares of non-resident corporations as interest. The amendment to that subsection simply clarifies the type of shares to which paragraph 258(3)(b) is intended to apply. This amendment is applicable to dividends received or deemed under the Act to have been received on shares acquired after 8:00 p.m. EDT, June 18, 1987.

Subclause 18(3)
ITA
258(5)

Subsections 112(2.2) and (2.4) of the Act disallow the intercorporate dividend deduction under subsections 112(1), (2) and 138(6) in respect of dividends paid on certain shares the value or yield of which is guaranteed and so-called collateralized preferred shares. In the case of such dividends received by a corporation from a foreign affiliate, the disallowance of the intercorporate deduction provided by section 113 would deprive that corporation of the relief for foreign tax paid which is built into the computation of the deduction provided by section 113. In order to prevent the corporation from claiming the deduction provided by section 113, but, at the same time, to allow it to benefit from the foreign tax credit with respect to any foreign withholding tax on these dividends, new subsection 258(5) treats these dividends as interest for the purposes of their inclusion in the corporation's income and the computation of the foreign tax credit. This amendment is applicable after June 18, 1987.

Subclauses 17(4), (5) and (6)

This sets out the effective dates for the amendments to section 258 of the Act.