Department of Finance Ministère des Finances

INFORMATION

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WAYS AND MEANS MOTION FOR TAX REFORM PROPOSALS TABLED

The Honourable Michael Wilson, Minister of Finance, today tabled a Notice of Ways and Means Motion in respect of various changes to the Income Tax Act proposed in his White Paper on tax reform and in the paper "Income Tax Reform".

While most of the tax reform proposals do not take effect until 1988 or later, the Minister said that this Notice of Motion reflects those tax change proposals that would be effective either as of June 18, 1987 or by reference to events occurring on or after that date. The Notice of Motion includes the following items:

- revised definition for qualified farm property acquired after June 17, 1987 for the purposes of the special $500,000 capital gains exemption;

- restriction of deductible capital cost allowances, lease expenses and carrying costs for passenger automobiles acquired or leased for business purposes after June 17, 1987, applicable for fiscal periods or taxation years commencing after June 17, 1987 and ending after 1987;

- rules relating to dividends on preferred shares paid after June 18, 1987;

- extension of the limited partnership "at risk" rules to resource expenditures, effective for limited partnerships commencing or significantly expanding their businesses after June 17, 1987;

- disallowance of reserves in respect of dispositions after June 17, 1987 giving rise to an eligible capital receipt;

- removal of R&D treatment for the cost of acquiring or renting a building after 1987 except for certain costs incurred pursuant to agreements made before June 18, 1987, or where the building was

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under construction by or on behalf of the taxpayer before that date;

- restriction of various automobile expenses where an automobile is not used all or substantially all for business purposes, effective for fiscal periods and taxation years commencing after June 17, 1987 and ending after 1987;

- rules providing for farmers to account for tax purposes on a modified accrual method, with a cash basis adjustment, and objective rules for distinguishing between full-time and part-time farmers, effective for fiscal periods commencing after June 17, 1987 and ending after 1987; and

- several measures applicable to banks and insurance companies that are applicable with respect to taxation years commencing after June 17, 1987.

The Minister also noted that a number of the tax reform proposals involve amendments to the Income Tax Regulations. While these do not require inclusion in a Notice of Ways and Means Motion, they may be important to taxpayers. Some of these changes to the Income Tax Regulations will be effective either on June 18, 1987 or with respect to events that occur on or after that date. These include:

- a new definition of prescribed shares for flow-through share purposes which is effective for shares issued after June 17, 1987 -- draft regulations for this definition are included in a separate press release;

- replacement of the 100-per-cent capital cost allowance rate for certified Canadian films with a 30-per-cent rate plus an additional allowance of up to the entire remaining cost of the investment to be applicable against all film income for the year, effective for films acquired after 1987 other than films acquired after that time pursuant to an agreement or public distribution before June 18, 1987;

- elimination of the multiple unit residential building (MURB) incentive effective for MURBs acquired after June 17, 1987 other than pursuant to an agreement entered into before that date (existing MURB owners will continue to benefit from the MURB provisions for taxation years ending before 1991);

- "grandfathering" in respect of other proposed changes to rates of capital cost allowance applying for property acquired after 1987 and before 1990 pursuant to an agreement entered into before June 18, 1987 or, in the case of buildings, where the building was under construction by or on behalf of the taxpayer before that date.

A copy of the Notice of Ways and Means Motion tabled by the Minister is attached.

NOTICE OF WAYS AND MEANS MOTION
TO AMEND THE INCOME TAX ACT

That it is expedient to amend the Income Tax Act to provide among other things:

Qualified Farm Property

(1) That for the purposes of the lifetime capital gains exemption, the definition in subsection 110.6(1) of the Act of "qualified farm property" of an individual exclude real property acquired by the individual after June 17, 1987, otherwise than pursuant to an agreement in writing entered into on or before that date, unless, for at least 24 months immediately before its disposition, it was owned by the individual, the spouse or a child of the individual and, before its disposition and while it was owned by any such person,

(a) in at least two calendar years, the gross revenues of the individual, the spouse or a child of the individual for a fiscal period ending in the year from the farming business in which the property was used exceeded the net income from all other sources in the year of the individual, the spouse or the child, as the case may be; or

(b) throughout a period of at least 24 months, the property was used by a family farm partnership or family farm corporation of the individual, the spouse or a child of the individual in the course of carrying on the business of farming in Canada.

Passenger Vehicles

(2) That for fiscal periods and taxation years commencing after June 17, 1987 and ending after 1987,

(a) the capital cost of a passenger vehicle acquired after June 17, 1987 be limited to $20,000;

(b) the amount deductible in respect of interest on money borrowed to acquire a passenger vehicle after June 17, 1987 not exceed $250 multiplied by the number of months in the period in respect of which it was paid or payable; and

(c) the amount deductible in respect of amounts paid or payable for the lease of a passenger vehicle having a value exceeding $20,000 be restricted where the lease agreement was entered into, extended or renewed after June 17, 1987;

and for this purpose "passenger vehicle" means an automobile, a station wagon, a passenger van or a similar motor vehicle designed to carry not more than nine persons but does not include an ambulance, a vehicle acquired primarily for use as a taxi or in connection with funerals or a vehicle acquired for hire in the course of a car rental or leasing business.

Motor Vehicle Expenses

(3) That for fiscal periods and taxation years commencing after June 17, 1987 and ending after 1987, with respect to any motor vehicle used by an individual less than 90% but more than 20% in the course of one or more income-earning activities, the following rules apply:

(a) the maximum deduction in computing the individual's income in respect of capital cost allowance, leasing expenses and interest on money borrowed in respect of the vehicle be limited to 1/5 of the amount otherwise deductible without taking into account the personal use of the vehicle;

(b) ordinary charges for insurance, licensing and parking at the regular place of business or employment of the individual not be deductible; and

(c) neither recapture nor terminal loss apply on the disposition of the vehicle.

Limited Partnerships

(4) That for taxation years ending after June 17, 1987, the following rules apply with respect to a taxpayer's interest (other than an exempt interest) as a limited partner within the meaning assigned by subsection 96(2.4) of the Act of a partnership:

(a) the taxpayer's share of resource expenditures incurred after June 17, 1987 by the partnership in its fiscal period ending in the year be limited to the amount by which his at-risk amount in respect of the partnership interest at the end of the period exceeds his share of the investment tax credit earned by the partnership in the period; and

(b) the taxpayer's share of resource expenditures in excess of the amount determined in respect thereof under subparagraph (a) be included in calculating his share of resource expenditures incurred by the partnership in its following fiscal period;

and for this purpose "exempt interest" has the meaning assigned by subsection 96(2.5) of the Act except that the references therein to "February 26, 1986" shall be read as "June 18, 1987", to "February 25, 1986" and "June 12, 1986" shall be read as "June 17, 1987", and to "January 1, 1987" shall be read as "January 1, 1988" and the reference therein to "prospectus, preliminary prospectus or registration statement" be read as including a reference to an "offering memorandum required to be filed before any distribution of securities may commence".

Eligible Capital Property

(5) That for dispositions of eligible capital property occurring at any time after June 17, 1987, other than pursuant to an agreement in writing entered into on or before that date, the proceeds of disposition be treated as having become payable at that time.

Research and Development Capital Expenditures

(6) That the cost of a building acquired after 1987, other than a prescribed special purpose building, a building acquired before 1990 pursuant to an obligation in writing entered into before June 18, 1987 or a building acquired before 1990 the construction of which was commenced before June 18, 1987 by or on behalf of the taxpayer or of a partnership of which he was a member, be denied treatment as a capital expenditure in respect of scientific research and experimental development.

Research and Development Qualified Expenditures

(7) That the provisions relating to a taxpayer's investment tax credit in respect of expenditures for scientific research and experimental development be amended to exclude from the definition of "qualified expenditure"

(a) any capital expenditure made in respect of a building acquired after 1987, other than a prescribed special purpose building, a building acquired before 1990 pursuant to an obligation in writing entered into before June 18, 1987 or a building acquired before 1990 the construction of which was commenced before June 18, 1987 by or on behalf of the taxpayer or of a partnership of which he was a member; and

(b) any payment made after 1987 in respect of the rental of a building, other than a prescribed special purpose building, unless the payment was made in respect of an agreement to lease in writing entered into on or before June 17, 1987 otherwise than pursuant to an extension or renewal after that date of the lease.

Short-Term Preferred Shares

(8) That dividends received by corporations on shares of non-related corporations issued after 8:00 p.m. E.D.T. June 18, 1987, other than grandfathered shares, that are retractable or required to

be redeemed within five years of their issue or shares that are convertible into such shares, be denied the intercorporate dividend deduction.

Dividends Received by Financial Institutions

(9) That dividends received after 1987 by a specified financial institution on taxable SFI shares (to be defined to include certain preferred shares that are issued before 8:00 p.m. E.D.T. June 18, 1987 or are grandfathered shares and that are not term preferred shares) be subject to a 10% tax in certain circumstances where the shares are acquired after 8:00 p.m. E.D.T. June 18, 1987.

Taxable Preferred Shares

(10) That, with respect to taxable preferred shares issued by a corporation after 8:00 p.m. E.D.T. June 18, 1987, other than grandfathered shares,

(a) the corporation be required to pay a special tax of 25% (or 40% where the corporation so elects) on dividends paid on such shares by it after 1987 and in a taxation year and be permitted to deduct 5/2 of this tax in computing taxable income for the year and to include the unused portion thereof in its non-capital loss for the year;

(b) the special tax not apply with respect to a dividend allowance of $500,000 of dividends on such shares paid in a taxation year by the corporation and any associated corporations subject to a reduction of the allowance for dividends paid in the preceding calendar year in excess of $1,000,000;

(c) a tax of 10% be payable by specified financial institutions, public corporations and certain other corporations on dividends received after 1987 on taxable preferred shares unless the corporation paying the dividend has elected to pay the special tax of 40% on such dividends;

(d) the taxes described in this paragraph not apply to certain qualifying investment intermediaries; and

(e) the taxes described in this paragraph not apply with respect to dividends paid by a corporation to a shareholder with a substantial interest in the corporation;

and for the purpose of this Motion,

(f) "taxable preferred shares" means shares other than most common shares;

(g) "grandfathered share" means a share, other than a qualifying common share, issued after 8:00 p.m. E.D.T. June 18, 1987 and before 1988 pursuant to an agreement in writing entered before 8:00 p.m. E.D.T. June 18, 1987 or in accordance with a prospectus, preliminary prospectus or registration statement, or an offering memorandum required to be filed before any distribution of securities may commence, filed before that time; and

(h) where the terms or conditions of a share or an agreement in respect of a share are changed or entered into at any time after 8:00 p.m. E.D.T. June 18, 1987, the share shall be deemed to be issued at that time.

Farming Income

(11) That for fiscal periods commencing after June 17, 1987 and ending after 1987, income from a farming business be determined on an accrual basis of accounting but a cash-basis reserve be allowed not exceeding the lesser of such income for the period and the amount by which the total of the inventory on hand, prepaid expenses and trade receivables exceeds accounts payable in respect of the business, at the end of the period.

Part-time Farmers

(12) That for fiscal periods commencing after June 17, 1987 and ending after 1987, losses for the period from a farming business deductible by a part-time farmer against other sources of income be limited to a maximum of $15,000 and that, for this purpose,

(a) a taxpayer in a farming business will be a part-time farmer

(i) for the 1988 or 1989 taxation year, unless, in at least one fiscal period ending after 1985 and before 1989 or, in the case of the 1989 taxation year, ending before 1990, gross revenues from the farming business exceed the taxpayer's income from all other sources in the corresponding taxation year,

(ii) for the 1990 or 1991 taxation year, unless, in at least two of the fiscal periods ending after 1985 and before 1991 or, in the case of the 1991 taxation year, ending before 1992, gross revenues from the farming business exceed the taxpayer's income from all other sources in the two corresponding taxation years, and

(iii) for the 1992 and subsequent taxation years, unless, in at least three of the fiscal periods ending in the year or the preceding six taxation years, gross revenues from the farming business exceed the taxpayer's income from all other sources in the three corresponding taxation years;

(b) special relief be provided from this rule in respect of the first four fiscal periods of a farming business that commences after June 17, 1987 where a prescribed form has been filed with Revenue Canada to support the fact that the business has a reasonable expectation of profit and, for such business, the rule described in subparagraph (a) for the 1992 and subsequent taxation years be modified to require that, in the fifth, sixth and seventh taxation years, the gross revenue test must be satisfied in at least one, two, and three taxation years, respectively; and

(c) where the first fiscal period of a farming business (other than the business of horse racing or horse breeding, show animal breeding or tree farming) of a taxpayer ends in 1987, the taxpayer will be considered to have satisfied the gross revenue test in the fiscal period that would have ended in 1986 if the farming business had been carried on before that time.

Reserve for Doubtful Accounts

(13) That, in computing the income of a person or partnership whose business includes the lending of money, for fiscal periods commencing after June 17, 1987 and ending after 1987, the amount of the deduction in respect of doubtful debts arising from loans made in the ordinary course of business generally be determined by reference to historical loan loss experience.

Life Insurance Reserves

(14) That, in computing the income of a life insurance corporation for a taxation year commencing after June 17, 1987 and ending after 1987.

(a) no amount be deductible in respect of policy dividends payable to its policy holders in a subsequent year under subparagraph 138(3)(a)(iv) of the Act;

(b) an amount be deductible in respect of a prorated portion of policy dividends that have accrued at the end of the year to or for the benefit of policy holders only to the extent that an amount in respect thereof has not been included in its policy reserve at the end of the year; and

(c) the maximum amount deductible as a reserve in respect of amounts payable under life insurance policies be computed using a 1 1/2 year preliminary term method rather than the existing 1 year preliminary term method.

Reserves: Transition

(15) That, where the aggregate of the reserves claimed by a person or partnership whose business includes the lending of money under paragraph 20(1)(l), subsections 26(2), 33(1) and 137(1) and paragraphs 137.1(3)(c), 138(3)(a) and (c) of the Act for its fiscal period immediately preceding its first fiscal period commencing after June 17, 1987 and ending after 1987 exceeds the maximum reserves that could have been claimed for that period if the changes proposed in paragraphs (13) and (14) were applicable to that period,

> (a) the amount of the excess be deductible in computing its income for its first fiscal period commencing after June 17, 1987 and ending after 1987 to the extent that such amount exceeds its unused non-capital loss carryover and other unclaimed deductions at the end of the preceding period; and
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> (b) a percentage of the amount so deducted be required to be included in computing its income in each of the next four fiscal periods to the extent of 15%, 25%, 25% and 35% thereof, respectively.

Unpaid Claim Reserves

(16) That, in computing the income of an insurance corporation for taxation years commencing after June 17, 1987 and ending after 1987, the amount deductible in respect of a reserve for unpaid claims made or to be made under policies of insurance be computed on a present value basis using a prescribed interest rate.

Multinational Insurers

(17) That, in computing the Canadian income of resident multinational life insurance corporations and non-resident insurance corporations, new rules be provided to determine that proportion of the corporation's world net investment revenue and security gains to be included for taxation years commencing after June 17, 1987 and ending after 1987.

Investment Income Tax

(18) That for taxation years commencing after June 17, 1987 and ending after 1987, a special 15% investment income tax apply to investment income accruing to fund insurance liabilities of life insurance companies and the rate be phased in over a 5 year period with a rate of 3% in 1988, 6% in 1989, 9% in 1990, 12% in 1991, 15% in 1992 and subsequent taxation years.