Explanatory Notes to a Notice of Ways and Means Motions Relating to Income Tax

Issued by
The Honourable Marc Lalonde
Minister of Finance

November 1983

Canada

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Department of Finance Canada
Ministère des Finances Canada

The explanatory notes are provided to assist in an understanding of the amendments proposed to the Income Tax Act. They are intended for informational purposes only and should not be construed as an official interpretation of the provisions they describe.

Preface

The amendments to the Income Tax Act set out in a Notice of Ways and Means Motions tabled in the House of Commons on November 25 incorporate the draft legislation covering various measures such as the new research and development financing mechanism, the Indexed Security Investment Program, and the proposals contained in my budget of April 19, 1983. In addition, it extends the deadline for issuance of farmers and small business bonds to the end of 1985.

This companion publication continues our recent practice of providing clause-by-clause explanations of the Income Tax amendments. The explanations set out the purpose of each amendment and describe the technical aspects of each change. While some of the material repeats explanations published previously to supplement the consultative process, the Ways and Means Motions incorporate a number of technical improvements to these measures. Accordingly, these explanatory notes have been updated to fully reflect all the changes. I hope you find them helpful.

As noted in the 23rd Report of the House Standing Committee on Finance, Trade and Economic Affairs, the purpose of these explanations is to assist Members of Parliament and other interested Canadians in understanding changes to the Income Tax Act. In this respect, I am pleased that this publication has been welcomed by all parliamentarians who contribute to Canada's tax legislative process.

The Honourable Marc Lalonde,
Minister of Finance,

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Taxable Income Defined
ITA
2(2)

Clause 1

Taxable income of a taxpayer for a taxation year is defined in subsection 2(2) of the Act as his income for the year minus personal exemptions, charitable donations and the other deductions permitted by Division C of the Act. Subsection 2(2) is amended to require the inclusion in taxable income of the addition to taxable income stipulated under Division C. This amendment is consequential on the introduction in 1982 of forward averaging. The addition to taxable income is provided in subsection 110.4(2) of the Act and enables a taxpayer to obtain a refund of taxes previously paid under forward averaging.

The amendment applies to the 1983 and subsequent taxation years.

Income for Taxation Year

Clause 2

Section 3 of the Act provides rules for determining a taxpayer's income for a taxation year for the purposes of Part I of the Act.

Subclause 2 (1)

ITA 3(b)(i)

Subparagraph 3(b)(i) includes a taxpayer's taxable capital gains for a taxation year in his income. The amendment to this subparagraph provides that taxable capital gains from indexed security investment plans are to be included in income to the extent they exceed allowable capital losses from indexed security investment plans.

Subclause 2 (2)

ITA 3(d)

Paragraph 3(d) of the Act provides for the deduction of various losses for a taxation year in the calculation of a taxpayer's income for the taxation year. The amendement to this paragraph provides that allowable capital losses from indexed security investment plans are to be similarly deducted to the extent they exceed taxable capital gains from indexed security investment plans.

Subclause 2 (3)

These amendments are applicable to taxation years ending after September, 1983.

Deductions From Income From Employment

Clause 3

Subclause 3(1)

ITA
8(1)(a)

Paragraph 8(1)(a) of the Act provides the employment expense deduction. The existing deduction is limited to the lesser of $500 and 3 per cent of the taxpayer's income for the year from an office or employment (including certain training allowances and scholarships). The amendment increases the percentage from 3 per cent to 20 per cent for the 1983 and subsequent taxation years.

Subclause 3(2)

ITA
8(10) and (11)

Subsections 8(10) and (11) of the Act provide for a deduction in computing an individual's income for a taxation year of 50 per cent of his overseas employment income for the year up to a maximum of $50,000. To qualify for the deduction, the individual must be resident in Canada in the year and must be employed abroad for six consecutive months or longer by a specified employer in connection with a contract for a construction, installation, agricultural, engineering or resource exploration or development project.

Effective for the 1984 and subsequent taxation years, this deduction will be replaced by an 80 per cent overseas employment tax credit under new section 122.3. Accordingly, subsections 8(10) and (11) are repealed effective for the 1984 and subsequent taxation years.

Subclauses 3(3) and (4)

These set out the effective dates for the amendments to section 8 of the Act.

Gains and Losses Not Included

ITA
9(3)

Clause 4

Subsection 9(3) of the Act specifies that a taxpayer's income or loss from a property excludes any capital gain or capital loss of the taxpayer from the disposition of property. The amendment to subsection 9(3) provides that any gain or loss from an indexed security investment plan as well as any gain or loss from the disposition of a security owned under such a plan are also excluded. This amendment is applicable to taxation years ending after September, 1983.

Inclusions in Income from Business or Property

Clause 5

Subclause 5(1)

ITA 12(1)(o)(v)

Paragraph 12(1)(o) of the Act requires a taxpayer to include in income amounts which became receivable in the year by the Crown in respect of production from a resource property in which the taxpayer had an interest. This paragraph applies when the federal or a provincial government has an interest in production from, or ownership of, a mineral resource or an oil or gas well.

Subparagraph 12(1)(o)(v) identifies the oil and gas and mineral interests which are subject to this rule. The amendment to this provision clarifies that such interests are only those with respect to which the statutory obligation (or contractual obligation substituted therefor) referred to in paragraph 12(1)(o) is imposed. The amendment applies to amounts that become receivable after April 19, 1983 in respect of any period after that date.

Subclause 5(2)

ITA 12(9)

Subsection 12(9) of the Act provides that an amount of income must be accrued on certain debt obligations in the manner prescribed in regulations and that this income is to be regarded as interest income. This computation provided in the regulations is relevant in determining the amount of interest to be included in income under the new accrual rules in subsections 12(3), (4), (8) and (11) and for the purpose of the rule in subsection 20(14) that applies on a transfer of a debt obligation. Subsection 12(9) is amended to add a reference to subsection 20(21) which is designed to provide a deduction to the extent that the amount of interest accrued and included in income on a debt obligation exceeds the interest actually received thereon. This reference is intended to ensure that the prescribed amount will be considered to have been included in income as interest for the purposes of paragraph 20(21)(b). This amendment is effective for taxation years commencing after 1981.

Subclause 5(3)

ITA 12(11)(a)

Paragraph 12(11)(a) of the Act defines "investment contract" which is the category of debt obligation subject to the accrual rule under subsection 12(4). An investment contract is defined to be any debt obligation other than an income bond or debenture, a small business development bond, a small business bond or a debt obligation in respect of which the taxpayer has always reported accrued interest income at intervals of less than three years. This amendment to paragraph 12(11)(a), for taxation years commencing after 1981, also excludes from the definition prescribed obligations. It is intended that debt obligations that are tax-exempt registered retirement savings plans be prescribed for this purpose.

Accrued Income on Life Insurance Polices and Annuities
ITA
12.2(4)

Clause 6

Subsection 12.2(3) of the Act provides that individuals must include accrued income on certain annuities and life insurance policies every three years. Subsection 12.2(4) provides an exception to this rule under which individuals may elect to be taxed annually on the accrued income. This subsection is amended, for taxation years commencing after 1982:

(a) to clarify that this election is not available to taxpayers, such as corporations, that are already required to accrue such income annually under subsection 12.2(1),

(b) to allow this election to be made for annuities under which payments have commenced, and

(c) to ensure that a different election can be made subsequently to treat an annuity as a prescribed annuity contract, which is not subject to a requirement to accrue income.

Small Business Development Bonds and Small Business Bonds
ITA
15.1 and 15.2

Clauses 7 and 8

Sections 15.1 and 15.2 of the Act contain the provisions that permit eligible small businesses in financial difficulty to issue small business development bonds and small business bonds. Interest on such bonds is not deductible by the issuer but is instead treated as a taxable divided to the recipient. Paragraphs 15.1(3)(b) and 15.2(3)(a) define the types of dept obligations that qualify for this treatment and require that such obligations be issued prior to 1984. The amendments to these paragraphs extend for a further two years, to the end of 1985, the period during which eligible small businesses in financial difficulty can issue small business development bonds and small business bonds.

Deductions Prohibited – Business and Property Income

Clause 9

Subclause 9(1)

ITA 18(3.1)(a)

Subsection 18(3.1) of the Act generally prevents the deduction of expenses that relate to and are incurred in the course of the construction, renovation or alteration of a building. The subsection requires these expenses to be added to the cost of the building or land as appropriate. Sections 37 and 37.1 permit the deduction on a current basis of certain expenditures made in respect of scientific research, including the cost of depreciable research equipment, facilities and buildings. Under the existing provisions, scientific research expenditures on buildings are technically subject to the provisions of subsection 18(3.1). Paragraph 18(3.1)(a) of the Act is amended, effective for expenditures made after 1981, to ensure that it does not restrict the deduction of research expenditures that qualify under sections 37 and 37.1.

Subclause 9(2)

ITA 18(11)(e), (f), (g) and (h)

Paragraphs 20(1)(c), (d), (e) and (k) of the Act permit a deduction for interest and other expenses in respect of money borrowed for the purpose of gaining or producing income from a business or property. Subsection 18(11) prohibits the deduction of these expenses in respect of indebtedness incurred for certain purposes. New paragraphs 18(11)(e), (f), (g) and (h), effective for taxation years ending after September, 1983, extend this prohibition to indebtedness relating to securities acquired or owned under an indexed security investment plan as well as to certain indebtedness incurred to acquire an interest in, or make a contribution or loan to, a trust that is, or becomes, a participant under an indexed security investment plan. The limitation does not apply with respect to interest and other borrowing costs relating to a period when the security was not acquired or owned under an indexed security investment plan or when the trust was not a participant under an indexed security investment plan.

Subclauses 9(3) and (4)

These set out the effective dates for the amendments to section 18 of the Act.

ITA
18(1)(m)(v)

Cross Reference

The coming into force provision governing subparagraph 18(1)(m)(v) is amended by Clause 110 (see commentary thereunder).

Deductions Permitted – Business and Property Income

Clause 10

Subclause 10(1)

ITA 20(1)(m.2)

Paragraph 12(1)(a) of the Act provides for the inclusion in business income of amounts received in a taxation year on account of goods not delivered or services not rendered before the end of the year. Where such amounts have been included in a taxpayer's income for the year or a preceding year, paragraph 20(1)(m) of the Act permits the deduction of a reasonable reserve in respect of goods and services that it is reasonably anticipated will have to be delivered or rendered after the end of the year.

A technical problem arises where the goods or services are not delivered or rendered but instead the amount received is subsequently repaid by the recipient. In this case, paragraph 20(1)(m) does not operate to allow a reserve nor does the Act specifically provide any deduction for the repaid amount. This amendment adds new paragraph 20(1)(m.2) to the Act to expressly provide for the deduction by a taxpayer of repayments in the year of amounts included under paragraph 12(1)(a) in computing his income for the year or a preceding year. This new paragraph is applicable with respect to the deduction of repayments made in the 1982 and subsequent taxation years.

Subclause 10(2)

ITA 20(1)(11)

A taxpayer who has made an overpayment on account of his tax payable under either the Income Tax Act or the Petroleum and Gas Revenue Tax Act may receive interest in respect of the overpayment. However, where it is subsequently determined that the overpayment is less than previously calculated, new subsection 164(3.1) of the Act (and a corresponding provision of the Petroleum and Gas Revenue Tax Act) provide that the Minister may recover any excess interest previously paid to a taxpayer in respect of the overpayment. Since such interest received by a taxpayer must be included in calculating his income, new paragraph 20(1)(11), applicable with respect to repayments of excess interest made after April 19, 1983, provides a deduction for interest that is now required to be repaid in the year. The deduction is available to the extent that such interest has been included in computing the taxpayer's income and was not exempt from tax by virtue of the $1,000 investment income deduction provided in section 110.1 of the Act.

Subclause 10(3)

ITA 20(14.1)

Subsection 20(14) of the Act provides rules for apportioning interest when debt obligations are transferred on a date other than that on which interest is payable. Under these rules, where a debt obligation with accrued interest attached is purchased from another holder, the purchaser is allowed a deduction in respect of the interest accrued thereon at the date of purchase. This deduction is made at the time the interest is subsequently paid. New subsection 20(14.1) provides a similar rule when a debt obligation is issued after the date from which interest is stipulated to be payable. In this case the original lender will be required to pay a premium to the borrower for the interest accruing before the issue date and he will be allowed under new subsection 20(14.1) to deduct this premium from any interest he subsequently receives. This new subsection is effective for taxation years commencing after 1982.

Subclause 10(4)

ITA 20(20)

Subsection 20(20) of the Act provides a deduction in respect of any over-accrual of income on a life insurance policy last acquired after December 1, 1982 or an annuity contract under which payments have not commenced. The computation of the over-accural is made and the deduction is allowed at the time the insurance policy or annuity contract is disposed of. The deduction is limited to the lesser of the amount of accrued income previously taxed and an amount determined in prescribed manner under paragraph 20(20)(b). Subsection 20(20) is amended, for taxation years commencing after 1982,

(a) to provide that the limitation of the deduction in paragraph 20(20)(b) is the amount by which the adjusted cost basis of the holder's interest in the policy or contract exceeds the proceeds, rather than an amount determined in prescribed manner, and

(b) to remove the references to paragraph 56(1)(d.1), which are inappropriate since that paragraph is relevant only for those annuity contracts under which payments have commenced.

ITA 20(21)

Subsection 20(21) of the Act provides a deduction in respect of any over-accrual of interest on a debt obligation at the time the obligation is disposed of. The subsection is amended, for taxation years commencing after 1982, to ensure that all amounts received in respect of interest on the obligation, including amounts deemed under subsection 12(9) of the Act to accrue as interest, will be included under paragraph 20(21)(b). A further amendment addresses partial dispositions of debt obligations and ensures that the deduction relating to an over-accrual is to be determined in respect of the taxpayer's interest disposed of rather than the whole debt obligation.

Subclauses 10(5) to (7)

These set out the effective dates for the amendments to section 20 of the Act.

Scientific Research Deduction

ITA
37(1)

Clause 11

Subsection 37(1) of the Act allows a taxpayer to deduct an amount for scientific research expenditures made in the current taxation year or previous taxation years to the extent that they have not previously been deducted.

New paragraph 37(1)(g) is added to the Act in consequence of the new scientific research tax credit financing mechanism, which is described in the commentary on new section 127.3 of the Act. Where this financing mechanism is used, the corporation is required to pay a special tax under Part VIII. However, this Part VIII tax may be refunded to the corporation when it renounces its right to deduct certain scientific research expenditures; $1 of Part VIII tax is refunded for each $2 of renounced expenditures. Paragraph 37(1)(g) is the provision which denies the deduction for these renounced expenditures. A corresponding amendment is also made to paragraph 127(10.1)(c) of the Act which prevents these renounced expenditures from qualifying for the investment tax credit. The new paragraph applies to the 1983 and subsequent taxation years.

Additional Allowance for Scientific Research

ITA
37.1

Clause 12

Section 37.1 allows a corporation to deduct in a taxation year an amount equal to 50 per cent of its incremental scientific research expenditures for the year. Subject to certain transitional provisions, this additional allowance is being eliminated for taxation years ending after October 1983. It is replaced with an enhanced investment tax credit which is described in the commentary on new paragraph 127(11.1)(c) of the Act.

Clause 12 provides a transitional rule for taxation years that include November 1, 1983 and for grandfathered expenditures described in subparagraphs (b)(i) and (ii) of the clause. Where a corporation's taxation year includes November 1, 1983, it may elect to have section 37.1 apply in respect of all of its scientific research expenditures for the year. A separate rule applies in respect of grandfathered expenditures to allow as a deduction only a proportion of the additional allowance otherwise determined. The proportion allowed is the ratio of grandfathered expenditures to total scientific research expenditures in the year.

Example

Total R&D Expenditures	\$500
Incremental R&D Expenditures	\$300
Grandfathered R&D Expenditures	\$250
Additional Allowance otherwise determined—50% of \$300=	\$150
Additional Allowance $\frac{250}{500} \times \$150=$	\$ 75

Taxable Capital Gains and Allowable Capital Losses
ITA
38(d) and (e)

Clause 13

Section 38 of the Act defines the amount of a taxpayer's taxable capital gain, allowable capital loss or allowable business investment loss for a taxation year from the disposition of a property. The amendments to this section, applicable to taxation years ending after September 1983, are consequential on the introduction of the indexed security investment plan.

New paragraph 38(d) provides that a taxpayer's taxable capital gain for a taxation year from an indexed security investment plan is one-half of the amount by which his capital gain for the year from the plan exceeds any administration fees paid in the year in respect of the plan.

New paragraph 38(e) provides that a taxpayer's allowable capital loss for a taxation year from an indexed security investment plan is one-half of the sum of his capital loss for the year from the plan plus the amount by which the administration fees exceed any capital gain for the year from the plan.

As a consequence of these amendments, one-half of fees or expenses related to the administration of an indexed security investment plan will be deductible in a year either as a reduction of the taxpayer's taxable capital gain from the plan or as an increase in the taxpayer's allowable capital loss from the plan.

Capital Gain and Loss

Clause 14

Section 39 of the Act sets out the meaning of capital gain and capital loss. The amendments to this section are consequential on the introduction of the indexed security investment plan and the share-purchase and scientific research tax credits.

Subclauses 14(1) and (2)

ITA 39(1)(a)(v) and (b)(ii)

Paragraphs 39(1)(a) and (b) of the Act define a taxpayer's capital gain or loss for a taxation year from the disposition of a property. New subparagraph 39(1)(a)(v) and the amendment to subparagraph 39(1)(b)(ii) exclude a gain or loss realized on the disposition of a security owned under an indexed security investment plan from the meaning of capital gain or capital loss.

Subclause 14(3)

ITA 39(6)

Subsection 39(4) of the Act permits certain taxpayers to elect to treat all Canadian securities owned by them as capital property, thereby ensuring that any gains or losses on their disposal are capital gains or losses. Subsection 39(6) defines "Canadian security" for this purpose. The amendment to subsection 39(6) ensures that gains or losses on the disposition of securities owned under an indexed security investment plan will not be treated as capital gains or losses by virtue of the election under subsection 39(4). Such gains and losses are dealt with separately in new section 47.1 of the Act.

ITA 39(7) and (8)

Subsections 39(7) and (8) of the Act have been added as a consequence of the introduction of the share-purchase tax credit as provided in new section 127.2 and Part VII of the Act and the scientific research tax credit as provided in new section 127.3 and Part VIII of the Act. These new subsections provide that where a taxpayer does not have sufficient tax payable either in the year in which such a tax credit is earned or in his immediately preceding taxation year, any remaining unutilized portion of the credit will be treated as a capital loss for the year following the year in which the tax credit is earned. These subsections are applicable in respect of the 1983 and subsequent taxation years.

Subclauses 14(4) to (6)

These set out the effective dates for the amendments to section 39 of the Act.

Clause 15

Losses on Transferring Securities to an Indexed Security Investment Plan
ITA
40(2)(j)

Subclause 15(1)

Subsection 40(2) of the Act provides special rules to determine the amount of capital gain or capital loss in certain circumstances. New paragraph 40(2)(j), applicable after September 1983, provides that any capital loss arising on the transfer of a security to an indexed security investment plan within 60 days after the security was acquired outside the plan is reduced by the amount of any commissions and other expenses incurred in acquiring that security.

Subclause 15(2)

ITA
40(3.1)

New subsection 40(3.1) limits the amount of capital losses arising on transfers of securities to indexed security investment plans to the amount of capital gains arising on such transfers. Capital losses in excess of this amount are deemed to be offset by an equivalent capital gain. This amendment will only apply to taxation years commencing after December 31, 1984 in order to provide a transitional period during which existing investment portfolios can be transferred to indexed security investment plans without the application of this loss limitation.

Subclauses 15(3) and (4)

These set out the effective dates for the amendments to section 40 of the Act.

Listed-Personal-Property Losses
ITA
41(2)(b)

Clause 16

Losses from the disposition of property owned for personal use or enjoyment are generally not deductible for tax purposes. Section 41 of the Act provides, however, that a loss in a taxation year arising from the disposition of listed personal property—a defined term which includes works of art, jewelry, rare books, stamps and coins—is available to offset listed-personal-property gains for the year. In addition, any such loss that is not utilized in the year may be carried over to be deducted against listed-personal-property gains of the immediately preceding and five following taxation years. An amendment to paragraph 41(2)(b) permits listed-personal-property losses to be carried back three years and forward seven years. This amendment generally applies with respect to listed-personal-property losses incurred in the 1984 and subsequent taxation years. However, a 1984 loss may be carried back only two years.

A further amendment allows a taxpayer to deduct any portion of a listed-personal-property loss against gains of any taxation year in the carryover period. Thus, a taxpayer may choose not to claim the maximum loss to which he is entitled in a year and may choose instead to apply all or any portion thereof to a subsequent year. This contrasts with the existing requirement that losses be applied to the earliest years first and to the full extent of listed-personal-property gains of those years. This amendment applies to listed-personal-property losses incurred in the 1983 and subsequent taxation years and to the carry-forward of such losses to the 1983 and subsequent taxation years.

Where Identical Properties are Indexed Securities
ITA
47(4)

Clause 17

Section 47 of the Act provides that the costs of identical properties acquired by a taxpayer after 1971 are to be averaged for purposes of calculating the adjusted cost base of the properties. New subsection 47(4) provides that the cost of any property held under an indexed security investment plan will not be considered in calculating the adjusted cost base of identical properties owned by the taxpayer outside the plan. This amendment is applicable after September 1983.

Indexed Security Investment Plans

Clause 18

New section 47.1 contains the basic rules, applicable after September 30, 1983, that govern indexed security investment plans. A taxpayer may enter into a contract with a plan administrator to own qualified Canadian securities under an indexed security investment plan. The cost of investments owned under the plan are indexed for inflation and 25 per cent of a taxable capital gain or allowable capital loss from the plan is recognized for income tax purposes on an accrual basis. The administrator of the indexed security investment plan is required to compute the taxpayer's taxable capital gain or allowable capital loss for the year from the plan and to provide him with appropriate information annually.

Subsection 47.1(1) provides the necessary definitions. Subsection 47.1(2) deals with acquisitions and dispositions of indexed securities. Subsections 47.1(3) to (9) deal with the computations required under the plan. Subsections 47.1(10) to (26) contain special rules.

Definitions
ITA
47.1(1)(a)

Paragraph 47.1(1)(a) defines "administrator" of an indexed security investment plan to be a 'trader or dealer in securities', a mutual fund corporation, a mutual fund trust or an insurer who has entered into a contract with a 'participant' to administer an indexed security investment plan. The term 'trader or dealer in securities' is defined in paragraph (1) and includes stock brokers as well as banks, trust companies and credit unions. The term 'participant' is defined in paragraph (h).

ITA
47.1(1)(b) and (c)

Paragraphs 47.1(1)(b) and (c) define "capital gain" and "capital loss" of a taxpayer for a taxation year from an indexed security investment plan by reference to the various subsections of the Act that deal with such plans. One-half of any capital gain or capital loss from a plan in a year will be included in computing the taxpayer's income for the year by virtue of new paragraphs 38(d) and (e) and the amendments to paragraphs 3(b) and (d).

ITA
47.1(1)(d)

Paragraph 47.1(1)(d) defines "fair market value" of a security at a particular time. In the case of a security listed or traded on a prescribed stock exchange in Canada and owned under or in respect of a plan or transferred to a plan, the fair market value is the quoted price determined under the method regularly followed by the administrator of the plan in determining such prices. In the case of a share of a mutual fund corporation, a unit of a mutual fund trust or an interest in a related segregated fund trust, the fair market value is the amount that would be received if the security were disposed of or redeemed at the particular time.

ITA
47.1(1)(e)

Paragraph 47.1(1)(e) defines an "indexed security" to be a qualified security owned by a taxpayer under an indexed security investment plan. Where the administrator of the plan is a 'trader or dealer in securities', such security must be held in the care and custody of a trader or dealer and registered in the name of a trader or dealer or his nominee. The term 'qualified security' is defined in paragraph (j).

ITA
47.1(1)(f)

Paragraph 47.1(1)(f) defines an "indexed security investment plan" to be a plan evidenced by a written contract between an administrator resident or licensed to carry on business in Canada and an individual (including most trusts) resident in Canada under which the administrator agrees to compute annually the individual's taxable capital gain or allowable capital loss from the plan.

ITA 47.1(1)(g)

Paragraph 47.1(1)(g) defines the term "indexing factor" for a particular month as the ratio of the Consumer Price Index for the preceding month to the Consumer Price Index for the second preceding month. The indexing factor for a particular month is used in the calculation of the indexing base of an indexed security investment plan at the end of that month. The definition uses the Consumer Price Index for each of the two preceding months in order to facilitate computations on a timely basis.

ITA 47.1(1)(h)

Paragraph 47.1(1)(h) defines a "participant" under an indexed security investment plan to mean an individual resident in Canada who has entered into an indexed security investment plan contract. Where a participant dies, a spouse or spouse trust that has acquired all the rights and assumed all the obligations under the plan and that meets the conditions set out under new paragraph 70(5.4)(g) will become the participant under the deceased's plan.

ITA 47.1(1)(i)

Paragraph 47.1(1)(i) provides that for the purposes of section 47.1, "Plan" means an indexed security investment plan.

ITA 47.1(1)(j)

New paragraph 47.1(1)(j) defines "qualified security" in relation to an indexed security investment plan. In the case of a plan administered by a trader or dealer in securities, a prescribed stock exchange in Canada must certify that a security meets certain conditions in order for it to be a qualified security. The prescribed exchanges are set out in Regulation 3200 and are the Alberta Stock Exchange, the Montreal Stock Exchange, the Toronto Stock Exchange, the Vancouver Stock Exchange and the Winnipeg Stock Exchange. In addition the definition of "qualified security" provides for a number of other requirements.

Securities eligible for certification include most listed common shares of corporations incorporated and having their head office in Canada as well as posted rights and warrants to acquire such shares. Also included are certain publicly traded options to buy or sell eligible shares. Shares of a mutual fund corporation are not eligible for certification in this manner.

Where 25 per cent or more of any class of the issued shares of a corporation are owned by a participant under a plan, persons with whom he does not deal at arm's length, or a combination thereof, that corporation's shares will not be qualified securities for that participant's plan.

In the case of an indexed security investment plan administered by a mutual fund corporation, a mutual fund trust or an insurer with respect to a related segregated fund trust, a qualified security is a share of the capital stock of the mutual fund corporation, a unit of the mutual fund trust or an interest in the related segregated fund trust, as the case may be. There is no requirement that these securities be certified in order to qualify for an indexed security investment plan.

ITA 47.1(1)(k)

Paragraph 47.1(1)(k) defines "specified adjustment factor" for a taxation year in respect of an indexed security investment plan. The specified adjustment factor is used primarily in the computation of a taxpayer's gain or loss from an indexed security investment plan administered by a mutual fund corporation, a mutual fund trust or an insurer in respect of a related segregated fund trust (in this paragraph referred to as the "fund"). It is a weighted average computation of the portion of a fund's total assets that are non-qualified assets, determined as at two points in each month in the year. The specified adjustment factor reduces the indexing benefit otherwise available to a taxpayer in a year if over the year more than 10 per cent of the assets of the fund are non-qualified assets on a weighted average basis. The 10 per cent allowance for non-qualified assets recognizes that funds need to maintain some cash balances to meet redemptions.

In order to limit the availability of the indexing benefit to taxpayers who invest in those funds which primarily hold qualified securities, any fund whose specified adjustment factor exceeds 40 per cent will be deemed to have a specified adjustment factor of one. As a result there will be no indexing benefit with respect to such a fund.

In the case of plans administered by traders or dealers in securities, the specified adjustment factor is deemed to be nil.

ITA 47.1(1)(l)

Paragraph 47.1(1)(l) defines "trader or dealer in securities" to be persons resident in Canada who are registered or licensed under the laws of a province to trade in securities and who are members of a prescribed contingency fund. It is proposed that the National Contingency Fund will be prescribed for this purpose, thus including most stock brockers in Canada in this definition. Also included are chartered banks, trust companies and credit unions resident in Canada that act as agents in the purchase and sale of securities.

ITA 47.1(2)

Subsection 47.1(2) provides rules to be used when a taxpayer acquires or disposes of a security that is a qualified security in relation to an indexed security investment plan and which the taxpayer would otherwise treat as capital property. The subsection also applies where a qualified security owned outside an indexed security investment plan is transferred to such a plan.

Paragraph 47.1(2)(a) applies where a security was treated by an administrator of an indexed security investment plan as having been acquired or disposed of under the plan in a particular month. Unless the participant advises the administrator within the first twenty-one days of the following month that this treatment is incorrect, the security is deemed to have been acquired or disposed of under the plan as reported by the administrator. New paragraph 47.1(2)(b) provides similar rules in the case of a security treated by the administrator as having been acquired or disposed of outside of the plan.

Paragraph 47.1(2)(c) applies where a security acquired outside an indexed security investment plan is subsequently transferred to the plan. Where a taxpayer transfers a security owned by him into an indexed security investment plan, that security is deemed to have been disposed of outside the plan for proceeds of disposition equal to its fair market value and to have been reacquired under the plan at a cost equal to that fair market value. Any taxable capital gain or allowable capital loss arising on the deemed disposition will be included or deducted in determining the taxpayer's income for the year of transfer. Special rules contained in paragraph 40(2)(j) and subsection 40(3.1) may apply to restrict the deductibility of capital losses arising in these circumstances.

ITA 47.1(3)

Subsection 47.1(3) determines the indexing base of an indexed security investment plan at the beginning of a taxpayer's taxation year. In general, the indexing base of an indexed security investment plan at the beginning of the year is the fair market value of all indexed securities owned under the plan at the end of the preceding year adjusted for any deferred loss or any deferred gain from the plan for that preceding year and for the cost of closing out certain put and call options written under the plan. Such a deferred gain or loss will arise by virtue of subsection 47.1(9) which generally provides that only 25 per cent of a gain or loss for a taxation year from an indexed security investment plan is taken into account for tax purposes in that year.

ITA 47.1(4)

Subsection 47.1(4) determines the indexing base of an indexed security investment plan at the end of a month and the taxpayer's indexed gain amount for a month.

Paragraph 47.1(4)(a) defines the indexing base of an indexed security investment plan as the sum of:

1. the indexing base at the end of the previous month (or, in the case of the first month of the taxation year, at the beginning of the year) multiplied by the indexing factor for the month;
2. the cost of each indexed security acquired during the month; and
3. the cost of closing out each put or call option written under the plan that was closed out in the month;

less the sum of

4. the proceeds from each disposition of an indexed security in the month minus any costs incurred in making the disposition;
5. the net proceeds received on the writing of a call option under the plan provided that the call option relates to:
   a) an indexed security owned under the plan;
   b) a call option owned under the plan that together with the written call option is recognized as a spread position by a prescribed stock exchange in Canada; or
   c) a right or warrant owned under the plan that does not expire prior to the time at which the written call option expires;
6. the proceeds received on the writing of a put option under the plan, provided such option relates to a qualified security that the participant will acquire under the plan if that option is exercised, less any costs incurred in writing the option; and
7. the excess of the total of indexed gain amounts for preceding months in the year over any such indexed gain amounts applied in the year to reduce the indexing base of the plan at the end of any such month in the year.

The indexing factor for a particular month is defined in paragraph 47.1(1)(g). A security acquired during a month is not indexed until the following month. Similarly, a security disposed of during a month continues to receive indexing for that month provided it was owned under the plan at the beginning of that month.

The indexing base of a plan at the end of any month cannot be negative. Where this would otherwise happen, an indexed gain amount for the month from the plan will result as defined in paragraph 47.1(4)(b). An indexed gain amount is not subject to indexing. Rather it is accumulated during the year and applied under paragraph 47.1(4)(a) in computing the indexing base of the plan at the end of any subsequent month in the year in which additional securities are acquired under the plan. If an unapplied balance remains at the end of the year it is included in computing the taxpayer's indexed gain or loss for the year from the plan under subsection 47.1(5).

ITA 47.1(5)

Subsection 47.1(5) determines the indexed gain or loss of a taxpayer for a taxation year from an indexed security investment plan. The indexed gain or loss is then used in subsection 47.1(7) to determine the gain or loss of the taxpayer from the plan for the year. The gain or loss is used in subsection 47.1(9) to determine the taxpayer's capital gain or capital loss from the plan.

A taxpayer's indexed gain for a year from a plan will normally be the amount by which the fair market value of all indexed securities owned by the taxpayer under the plan at the end of the last month of the year exceeds the indexing base of the plan at that time less the cost of closing out any put and call options written under the plan that are outstanding at the end of the year. However, where the aggregate of the indexed gain amounts, if any, for each month in the year exceeds the amounts applied under paragraph 47.1(4)(a) to reduce the indexing base at the end of any month in the year, the indexing base at the end of the year will be nil. In this case, the taxpayer's indexed gain for the year will be the sum of the fair market values of all indexed securities owned by the taxpayer under the plan at the end of the year (less the cost of closing out any put and call options written under the plan that are outstanding at the end of the year) plus the unutilized indexed gain amounts.

A taxpayer's indexed loss for a year from a plan is the amount by which the indexing base of the plan at the end of the last month in the year exceeds the fair market value of all indexed securities owned by the taxpayer under the plan at that time less the cost of closing out any put and call options written under the plan that are outstanding at the end of the year.

ITA 47.1(6)

Subsection 47.1(6) determines the unindexed gain or loss of a taxpayer for a taxation year from an indexed security investment plan. It is the amount that would be the indexed gain or loss of the taxpayer for the year from the plan if there was no inflation for the year. The unindexed gain or loss is necessary to determine the taxpayer's gain or loss for the year from a plan administered by a mutual fund trust, a mutual fund corporation or an insurer. This determination is described in more detail in the explanation to subsection 47.1(7).

ITA 47.1(7)

Subsection 47.1(7) determines the gain or loss of a taxpayer for a taxation year from an indexed security investment plan. Where the plan is administered by a trader or dealer in securities, the gain or loss will normally be equal to the indexed gain or loss determined under new subsection 47.1(5).

In the case of other plans, there will be a reduction in the indexing benefit to the extent that the specified adjustment factor of the taxpayer for the year in respect of the plan is greater than nil. The reduction in the indexing benefit is calculated by multiplying the specified adjustment factor by the difference between the unindexed gain or loss and the indexed gain or loss. The resulting product is then used to increase the indexed gain or decrease the indexed loss, as the case may be.

ITA 47.1(8)

New subsection 47.1(8) modifies the computation under subsection 47.1(7) of the gain or loss of a taxpayer for a year from an indexed security investment plan when inflation is negative during the period in the year when the plan was in operation. Where the plan was in operation during the full year, inflation is measured from the second month preceding the beginning of the year to the next to last month in the year. Where the plan was established during the year, inflation is measured from the month preceding the month of establishment. Where the plan was terminated during the year, inflation is measured up to the month preceding the month of termination.

Where negative inflation occurs, indexing will have reduced the indexing base of the plan and a purchasing power gain will have occurred that is not reflected in the taxpayer's unindexed gain or loss from the plan. Subsection 47.1(8) modifies subsection 47.1(7) so that the taxpayer's gain or loss from the plan includes the appropriate real gain from negative inflation.

ITA 47.1(9)

Subsection 47.1(9) determines a taxpayer's capital gain or capital loss for a year from an indexed security investment plan. This amount is then halved under paragraphs 38(d) or (e) to determine the taxpayer's taxable capital gain or allowable capital loss for the year from the plan.

A taxpayer's capital gain for a year from an indexed security investment plan will generally be 25 per cent of his gain for the year from the plan as determined under subsection 47.1(7). This defers recognition of 75 per cent of the gain. However, where the deferred portion of the gain exceeds the fair market value of all indexed securities owned by the taxpayer under the plan at the end of the year (less the cost of closing out any put and call options written under the plan that are outstanding at the end of the year), the excess will also be included in the taxpayer's capital gain for the year from the plan. This will occur only where realized gains have not been reinvested in new securities owned under the plan. A taxpayer's capital loss for a year from a plan is 25 per cent of his loss for the year from the plan.

ITA 47.1(10)

Subsection 47.1(10) applies where an indexed security investment plan is terminated. It treats all securities owned under the plan as having been disposed of under the plan immediately before the time of termination for proceeds equal to fair market value. It also treats the securities as having been reacquired outside the plan at a cost equal to such proceeds. (In addition, all put and call options written under the plan which are outstanding at the time of termination are treated as having been closed out under the plan immediately before the termination at the amount it would have actually cost to close them out on a prescribed stock exchange. Such options are treated as having been rewritten outside the plan for proceeds equal to that amount.) One fifth of any resulting loss is recognized in the year as a capital loss from the plan and the balance is amortized in equal amounts over the next four years. Any resulting gain will be fully recognized in the year as a capital gain from the plan since no securities will be owned under the plan at the end of the year.

ITA 47.1(11)

Subsection 47.1(11) treats an indexed security investment plan as having been terminated in three situations. The first is where no securities are owned under and no put or call options are outstanding under the plan at the end of a year and the loss from the plan for the year is less than $2500. The second is where the participant under the plan is a trust and the trust ceases to be a qualified trust as described in clause 47.1(1)(f)(i)(A). The third is where a participant writes a call option under his plan and the option is not written on a prescribed stock exchange in Canada. Where the plan is treated as terminated in these circumstances, the provisions of subsection 47.1(10) will apply.

ITA 47.1(12)

Subsection 47.1(12) provides an exception to the loss amortization rule in paragraph 47.1(10)(f). Where a trust is terminated in a year, the trust will be able to deduct any loss resulting from the termination of a plan by virtue of the termination of the trust in addition to any unamortized losses that relate to a plan terminated earlier in the year or in a previous year.

ITA 47.1(13)

Subsection 47.1(13) applies where an indexed security held under an indexed security investment plan is exchanged for or replaced by other property. The indexed security is deemed to have been disposed of for proceeds equal to the fair market value of the other property. Where the consideration received for the indexed security includes a qualified security, the qualified security is treated as an indexed security acquired under the plan at a cost equal to its fair market value. Any other property received as consideration is treated as having been acquired outside the plan at a cost equal to its fair market value.

ITA 47.1(14)

Subsection 47.1(14) treats certain rights and stock dividends received on securities held by a taxpayer under an indexed security investment plan as having been acquired under the plan at a cost equal to nil.

ITA 47.1(15)

Subsection 47.1(15) applies where a security owned by a taxpayer under an indexed security investment plan is withdrawn from the plan or ceases to be a qualified security in relation to the plan. In these circumstances the security is treated as having been disposed of under the plan for proceeds of disposition equal to its fair market value at that time and to have been reacquired outside the plan at a cost equal to that value.

ITA 47.1(16)

Subsection 47.1(16) applies in certain circumstances to treat a put or call option written under an indexed security investment plan as having been closed out and rewritten outside the plan. These provisions will apply where a put option written under a plan is exercised outside of the plan, where the security on which a put was written ceases to be a qualified security, where a call option written under a plan becomes an uncovered option or ceases to be part of a spread position and where the security upon which a call was written ceases to be a qualified security.

ITA 47.1(17)

Subsection 47.1(17) applies where a taxpayer disposes of a security owned under an indexed security investment plan by virtue of the exercise of a put option owned or a call option written outside the plan. In these circumstances, the taxpayer is treated as having disposed of the security under the plan immediately before the exercise of the option for proceeds of disposition equal to its fair market value and to have reacquired it outside of the plan at a cost equal to that value. As a result, the indexing base of the plan is reduced.

ITA 47.1(18)

Subsection 47.1(18) contains two special rules in those circumstances where a taxpayer owns a share of the capital stock of a mutual fund corporation under an indexed security investment plan. First, any capital gains dividends received by the taxpayer on the share are deemed not to have been received by the participant as a capital gain but rather as proceeds of disposition from the sale of the share. Accordingly, capital gains dividends will reduce the indexing base of the plan. Second, any amount received by the taxpayer on the redemption, in whole or in part, of the share will also be treated as proceeds of disposition and will thus reduce the indexing base of the plan. This provision does not affect the status of the capital gains dividend or redemption proceeds for purposes of determining the mutual fund corporation's capital gains refund.

ITA 47.1(19)

Subsection 47.1(19) contains two special rules in those circumstances where a taxpayer owns a unit of a mutual fund trust under an indexed security investment plan. First, where the trust allocates a capital gain realized by it to the taxpayer, the amount so allocated is deemed not to be a capital gain to the participant. Instead the amount allocated will be treated as proceeds from the disposition of the unit and will thus reduce the indexing base of the plan. Second, amounts received by the taxpayer as a distribution or payment of capital in respect of the unit will also be treated as proceeds of disposition thereby reducing the indexing base of the plan. This provision does not affect the determination of the mutual fund trust's capital gains refund.

ITA 47.1(20)

Subsection 47.1(20) contains four special rules in those circumstances where a taxpayer owns an interest in a related segregated fund trust under an indexed security investment plan administered by an insurer. First, where the insurer transfers property to the related segregated fund trust, there is an increase under subparagraph 138.1(1)(g)(ii) in the adjusted cost base to the taxpayer in respect of his interest in the trust. Paragraph 47.1(20)(a) provides that the increase in the cost base will be treated as a cost of acquiring an interest under the plan in the related segregated fund trust. This results in an increase in the indexing base of the plan.

Second, paragraph 138.1(1)(f) treats certain income of a related segregated fund trust as payable to the beneficiaries of the trust and thus taxable in their hands. Such income is never allocated to the beneficiaries as such. Since this is the equivalent of the trust paying out its income and the beneficiaries reinvesting the funds in the trust, it is appropriate that the indexing base of the indexed security investment plan should be adjusted. Under paragraph 47.1(20)(b) such amounts are treated as a cost of acquiring an interest in a related segregated fund trust and are added to the indexing base of the plan.

Third, under subsection 138.1(3) all capital gains and capital losses of a related segregated fund trust are treated as capital gains and capital losses of the beneficiaries under the trust and not as capital gains and capital losses of the trust. Under paragraph 47.1(20)(c) any amount so treated as a capital gain or capital loss of a beneficiary will not be included in computing the beneficiary's taxable capital gains or allowable capital losses if the beneficiary owns the interest in the trust under an indexed security investment plan.

Finally, where a taxpayer sells all or part of his interest in a related segregated fund trust, under subsection 138.1(4) the trustee may elect that certain capital properties are deemed to be disposed of at their fair market value and immediately reacquired at a cost equal to that fair market value. The trustee may then allocate the resulting capital gain or capital loss to the taxpayer who disposed of his interest in the trust. Under paragraph 47.1(20)(d), such an allocated capital gain or capital loss will be deemed not to be a capital gain or capital loss of the taxpayer if the interest in the trust was held under an indexed security investment plan.

ITA 47.1(21)

Subsection 47.1(21) applies where a taxpayer becomes a participant under two or more indexed security investment plans administered by the same trader or dealer in securities. It provides that all such plans will be treated as one plan for the purposes of section 47.1.

ITA 47.1(22)

Subsection 47.1(22) contains a special rule to allow all indexed securities owned and all options written by a taxpayer under an indexed security investment plan administered by a trader or dealer in securities to be transferred on a rollover basis to a second plan administered by another trader or dealer in securities. Where such a transfer occurs, the second trader or dealer will compute the taxpayer's capital gain or capital loss for the year from the plans as if he had been the administrator of both plans at all times in the year. This will require the first trader or dealer to inform the second of all transactions in the month of transfer and either the first plan's indexing base at the end of the preceding month or the unutilized indexed gain amount at the time of transfer, as the case may be. To implement this provision the first administrator will be required to give the second administrator a prescribed form containing prescribed information.

ITA 47.1(23)

Subsection 47.1(23) applies where the taxation year of a taxpayer who is a participant under an indexed security investment plan does not end at the end of a calendar month. This situation can arise where the taxpayer becomes a bankrupt during the year or where the taxpayer is a testamentary trust. In the case of a taxpayer becoming a bankrupt, all computations in respect of the plan will be made as if his taxation year were the period commencing at the beginning of the first calendar month ending in the year and running to the end of the calendar month in which he became a bankrupt. In the case of a testamentary trust, all computations in respect of the plan will be made as if the trust's taxation year were the period commencing at the beginning of the first calendar month of its taxation year and continuing to the end of the last calendar month ending in the year. These rules address the fact that the Consumer Price Index is only available in respect of calendar months and will assist plan administrators by only requiring computations at the end of calendar months.

ITA 47.1(24)

Subsection 47.1(24) reduces the benefit from indexation where a taxpayer who is a participant under an indexed security investment plan arranges his affairs in such a way as to artificially or unduly reduce a gain or increase or create a loss from a plan under which he, or a person with whom he does not deal at arm's length, is a participant. The rule will apply where the taxpayer withdraws or disposes of an indexed security owned under the plan and has an indexed gain amount in respect of the plan for any month in the year. Where the rule applies, the specified adjustment factor in respect of each plan involved will be deemed to be one. The effect will be that the participants under the plans involved will not receive a benefit from indexation in the taxation year in which the artificial or undue reduction, increase or creation occurred.

ITA 47.1(25)

Subsection 47.1(25) is a general anti-avoidance provision in respect of indexed security investment plans. Where as a result of one or more acquisitions, dispositions, exchanges, declarations of trust or other transactions under a plan (including the direct or indirect matching of a long position under a plan with a short position outside of that plan) a taxpayer may reasonably be considered to have artificially or unduly decreased or deferred the taxes otherwise payable under the Act for a taxation year, the plan will be deemed to have been terminated at the later of the time the plan was established and the beginning of the taxation year. As a result, the rules in subsection 47.1(10) with respect to the termination of a plan will apply. The taxpayer will receive no indexing benefit in respect of the plan for the year and all transactions which occurred under the plan during the year will be treated as having taken place outside the plan. This provision will not apply where subsection 47.1(24) is applicable.

ITA 47.1(26)

Subsection 47.1(26) requires that each administrator of an indexed security investment plan file with the Minister of National Revenue an annual information return with prescribed information within sixty days after the end of the taxation year of the participant. In addition, the administrator must forward two copies of the information return to the participant within the sixty day period.

Deemed Disposition of Property where a Taxpayer has Ceased to be Resident in Canada

Clause 19

Subclause 19(1)

ITA
48(1)

Subsection 48(1) of the Act provides that a taxpayer who ceases to be resident in Canada is treated as having disposed of each property he owns, with certain exceptions, for proceeds of disposition equal to its fair market value. This amendment exempts securities in an indexed security investment plan from the deemed disposition rule in subsection 48(1). Instead, new subsection 48(1.1) will apply to such securities.

Subclause 19(2)

ITA
48(1.1)

New subsection 48(1.1) provides that where, at any time in a taxation year, a participant under an indexed security investment plan ceases to be resident in Canada, all such plans under which he is a participant are deemed to be terminated immediately before that time. The taxpayer's capital gain or capital loss for the year from the plan will be the amount that otherwise would have been his gain or loss for that year from the plan. Thus any resulting gains or losses will be recognized in the year of departure. In addition, where the taxpayer had previously terminated a plan, any capital loss that would otherwise be amortized under the rules set out in subsection 47.1(10) will be deemed to be a capital loss from the plan for the year of departure, thus recognizing any remaining balance of such loss.

Subclause 19(3)

The amendments to section 48 of the Act are applicable with respect to taxpayers who cease to be resident in Canada after September, 1983.

Options

Clause 20

Subclause 20(1)

ITA 49(1)

Subsection 49(1) provides that where a taxpayer grants an option to acquire or dispose of a property, such granting is treated as a disposition of a property which has an adjusted cost base of nil. Thus the proceeds from the grant of the option are treated as a capital gain. The amendment to this subsection provides that, effective after September 30, 1983, the granting of an option under an indexed security investment plan is not to be treated as a disposition of property and, accordingly, will not result in a capital gain.

Subclause 20(2)

ITA 49(3)

Where a property is acquired or disposed of by virtue of the exercise of an option, subsection 49(3) normally applies to treat the previous granting of the option as not being a disposition. Instead, an adjustment is made, either to the proceeds received on the disposition of property or the cost of property acquired, as the case may be. Such an adjustment is not appropriate where a participant under an indexed security investment plan acquires or disposes of a security under the plan by virtue of the exercise of an option because the acquisition or granting of the option and acquisition or disposition of property on its exercise is accounted for in the indexing base of the plan.

Subclauses 20(3) and (4)

These set out the effective dates for the amendments to section 49 of the Act.

Capital Property – Cost Base Adjustments

Clause 21

Subclause 21(1)

ITA
53(1)(e)(i)(B)

Subparagraph 53(1)(e)(i) of the Act requires a taxpayer to add to the cost of a partnership interest his share of the partnership's income for a fiscal period computed without reference to those provisions of the Act that are specified in clauses (A) and (B) of that subparagraph. An amendment to clause (B) deletes the reference to paragraph 69(7.1)(b) as a consequence of the repeal of the provisions in subsection 69(7.1) relating to the sale of aviation turbine fuel used on international flights. This amendment is effective after the enacting Bill receives Royal Assent. A further amendment to clause (B), applicable to the 1982 and subsequent taxation years, adds references to paragraphs 81(1)(r) and (s) of the Act to ensure that an increase to the adjusted cost base occurs to reflect the receipt of incremental resource revenue that is not required to be included in income under the Act.

Subclause 21(2)

ITA
53(1)(i)(ii)

Paragraph 53(1)(i) of the Act allows for a special increase in the adjusted cost base of farm land for interest and property taxes to the extent that those expenses were not deductible by the taxpayer under the rules of the Act that restrict the deduction of certain farm losses. The increase effectively capitalizes the undeducted interest and property taxes into the land cost for purposes of determining any gain or loss on sale of the land. Under the present Act, a restricted farm loss is required to be claimed first in the earliest year in which it may be deducted. Under paragraph 111(1)(c) and subsection 111(3) of the Act as amended, a taxpayer may choose not to claim all or any part of a restricted farm loss in computing taxable income for any taxation year in the carryover period and he may instead carry such losses forward to be deducted in later years. The amendment to subparagraph 53(1)(i)(ii) is strictly consequential on this new flexibility in claiming losses. It substitutes a reference to restricted farm losses which were "not deducted" rather than "not deductible" in the year of disposition or in preceding years. This change applies to the 1983 and subsequent taxation years.

Subclause 21(3)

ITA
53(2)(c)(i)(B)

Subparagraph 53(2)(c)(i) of the Act requires a taxpayer to deduct from the cost of a partnership interest his share of the partnership's loss for a fiscal period computed without reference to those provisions of the Act that are specified in clauses (A) to (C) of the subparagraph. An amendment to clause (B) deletes the reference to paragraph 69(7.1)(b) as a consequence of the repeal of the provisions in subsection 69(7.1) relating to the sale of aviation turbine fuel used on international flights. This amendment is effective after the enacting Bill receives Royal Assent.

A further amendment to clause 53(2)(c)(i)(B), applicable to the 1982 and subsequent taxation years, adds references to paragraphs 81(1)(r) and (s) of the Act to ensure that an increase to adjusted cost base occurs to reflect the receipt of incremental resource revenue that is not required to be included in income under the Act.

Subclause 21(4)

ITA 53(2)(c)(vii)

Paragraph 53(2)(c) of the Act provides for certain deductions in computing the adjusted cost base of a partnership interest. New subparagraphs (vii) and (viii) are added to require a member of a partnership to reduce the adjusted cost base of his partnership interest by the amount of any share-purchase tax credit or scientific research tax credit allocated to him by the partnership. These amendments apply to the 1983 and subsequent taxation years.

Subclause 21(5)

ITA 53(2)(f)

Where a shareholder corporation makes a loan or payment to a joint exploration corporation in respect of Canadian exploration expenses, Canadian development expenses or Canadian oil and gas property expenses, the joint exploration corporation normally agrees to renounce those expenses in favour of the shareholder corporation. New subsection 66(10.4) and paragraph 53(2)(f.2) of the Act require the adjusted cost base of any property received by the shareholder corporation in consideration for such a payment or loan to be reduced by the amount of any such renounced expenses. The new subsection 66(10.4) and paragraph 53(2)(f.2) are applicable with respect to property (and certain property substituted therefor) received by a shareholder corporation as consideration for payments or loans made after April 19, 1983.

The amendment to paragraph 53(2)(f) is consequential on the change described above. Under the existing provisions, that paragraph reduces the adjusted cost base of any such property by the amount of any expenses renounced by a joint exploration corporation. Since the adjusted cost base of such property received after April 19, 1983 will be reduced by virtue of subsection 66(10.4) and paragraph 53(2)(f.2), the reduction of cost base under paragraph 53(2)(f) is no longer appropriate. Accordingly, paragraph 53(2)(f) is amended so that it does not apply with respect to property received as consideration for any payment or loan made after April 19, 1983.

Subclause 21(6)

ITA 53(2)(f.2)

Where a shareholder corporation makes a loan or payment to a joint exploration corporation in respect of Canadian exploration expenses, Canadian development expenses, or Canadian oil and gas property expenses, the joint exploration corporation normally agrees to renounce those expenses in favour of the shareholder corporation. New subsection 66(10.4) of the Act requires the amount of any such renounced expenses to be deducted from the adjusted cost base of any property received by the shareholder in consideration for such a payment or loan. The new subsection 66(10.4) also applies in respect of renounced expenses to require a reduction of the adjusted cost base of certain property substituted for such a property.

This amendment adds new paragraph 53(2)(f.2) which provides for the adjusted cost base deductions required by new subsection 66(10.4). New paragraph 53(2)(f.2) is applicable with respect to any property received by a shareholder corporation as consideration for payments or loans to a joint exploration corporation made after April 19, 1983.

Subclause 21(7)

ITA 53(2)(h)

Paragraph 53(2)(h) of the Act provides for certain deductions in computing the adjusted cost base of a beneficiary's capital interest in a trust or unit of a unit trust. New subparagraphs (iii) and (iv) are added to require a beneficiary of a trust to reduce the adjusted cost base of his capital interest in the trust by the amount of the share-purchase tax credit or scientific research tax credit that had been allocated to him by the trust. These amendments are applicable to the 1983 and subsequent taxation years.

Subclause 21(8)

ITA 53(2)(r)

Paragraph 53(2)(r) of the Act requires the amount of a life insurance capital dividend received on a share to be deducted in computing its adjusted cost base in certain circumstances where the share was acquired as a consequence of the death of a person. This ensures that any capital gain recognized by the deceased shareholder will not be offset by a capital loss that arises as a result of the receipt, in the form of a life insurance capital dividend, of tax-free insurance proceeds. The existing provision also extends the cost base adjustment to a share substituted for a share acquired as a consequence of the death and to a share of the same class acquired by the taxpayer after the death. Without a cost base reduction for shares of the same class acquired after death, a subsequent issue of a number of such shares would dilute the amount of a life insurance capital dividend that would be paid on the shares acquired as a consequence of death. This would reduce the amount of the appropriate cost base adjustment.

Several amendments are being made to this paragraph. First, an amendment, applicable after June 28, 1982, clarifies that the adjusted cost base reduction applies to a share of the same class acquired after death only if that share is acquired by a taxpayer who has acquired a share as a consequence of the death. A second amendment removes the exception for transactions described in subsection 84(2) with respect to windings-up commencing after 1983. A third amendment, applicable after June 28, 1982, clarifies that the cost base reduction under paragraph 53(2)(r) applies in respect of dividends that are deemed to be paid under subsections 84(2) and (3) of the Act.

Subclauses 21(9) to (13)

These set out the effective dates for the amendments to section 53 of the Act.

Definitions

Clause 22

Subclause 22 (1)

ITA 54(h)

Paragraph 54(h) defines the term "proceeds of disposition" of property. New subparagraph 54(h)(ix.1) includes in proceeds of disposition, any amount received on a reduction of the paid-up capital of a corporation in respect of a share in an indexed security investment plan. Such amounts reduce the indexing base of the plan under which the security is owned.

Subclause 22 (2)

ITA 54(i)(vi)

Paragraph 54(i) of the Act defines the term "superficial loss" of a taxpayer from the disposition of property. A superficial loss is not allowed as a capital loss. Subparagraph 54(i)(vi) provides that a loss that arises on a transfer of a security to an indexed security investment plan is a superficial loss only if the transferred security is withdrawn from the plan or disposed of to a non-arm's length person within 30 days of its original purchase. If the security is not so withdrawn or disposed of the loss will not be treated as a superficial loss. However, the deductibility of such losses may still be restricted by paragraph 40(2)(j) or subsection 40(3.1).

Subclause 22 (3)

This subclause provides that the amendments to section 54 of the Act are applicable after September 1983.

Butterfly Transactions

ITA
55(3)(b)

Clause 23

Paragraph 55(3) of the Act permits, as part of "butterfly" type reorganization, certain types of assets of a corporation to be distributed to its corporate shareholders on a tax-deferred basis. The June 28, 1982 draft legislation proposed to amend this paragraph along with paragraph 88(1)(d) to ensure that the cost base of the property distributed to the shareholders could not be increased. The amendment to paragraph 55(3)(b) as enacted by Bill C-139 was more restrictive than the June 28th draft legislation on this point but no change was made to the coming-into-force date of June 28, 1982. The amendment proposed by this Clause will exempt from the more restrictive rule those transactions that commenced on or before December 7, 1983—the date on which Bill C-139 was tabled.

Inclusions in Income from Other Sources

Clause 24

Section 56 of the Act provides for the inclusion in income of certain amounts that are not categorized as employment, business or property income.

ITA 56(1)(a)(i)

Subparagraph 56(1)(a)(i) of the Act includes in the income of a taxpayer superannuation or pension benefits received in a year. An exception is made in respect of an amount received out of or under an employee benefit plan that is required to be included in the taxpayer's income. The amendment to this subparagraph, applicable to the 1980 and subsequent taxation years, clarifies that any amount received out of or under an employee benefit plan as a return of the taxpayer's contributions to the plan is not required to be included in income.

Amounts Included In Income

Clause 25

Section 59 of the Act provides for certain inclusions in income with respect to the disposition of resource properties, the recovery of resource expenses and related depletion recapture provisions.

Subclause 25(1)

ITA 59(3.2)(d) and (e)

New paragraphs 59(3.2)(d) and (e) are consequential on the addition of new subsection 66(10.4) of the Act. The combined effect of paragraphs 59(3.2)(d) and (e) and subsection 66(10.4) is to require a shareholder corporation to include in its income certain renounced resource expenses described in subsection 66(10.4) which are not deducted in computing the cost or adjusted cost base of property of the shareholder corporation. This amendment is applicable after April 19, 1983.

Subclause 25(2)

ITA 59(3.3)(f)

As part of the April 19, 1983 budget it was announced that earned depletion on eligible mining exploration expenses would be deductible from any income source instead of from resource profits only. To implement this, it is intended that amendments be made to the Income Tax Regulations to provide for a new depletion base called a "mining exploration depletion base". Expenses which are eligible to be added to the new base will no longer be eligible to earn ordinary depletion. As a consequence of the creation of the mining exploration depletion base, new paragraph 59(3.3)(f) is added to the Act to require an income inclusion for recovered mining exploration depletion expenses in the same manner as is presently the case for ordinary depletion expenses that are recovered. New paragraph 59(3.3)(f) provides for an income inclusion of 33 ⅓ per cent of all amounts receivable by a taxpayer for property (other than a share, a resource property or depreciable property) or services the cost of which was added in computing his mining exploration depletion base or the mining exploration base of a specified predecessor of the taxpayer, as defined in new paragraph 59(3.4)(c).

Subclauses 25(3) and (4)

ITA 59(3.3)(f) and (3.4)

The successor rules in section 66, 66.1, 66.2 and 66.4 of the Act are being expanded to apply where a predecessor is an individual. Previously, those rules applied only where the predecessor was a corporation. The changes to the successor rules require consequential amendments to subsection 59(3.3) and paragraph 59(3.4)(a) of the Act. The definition of "successor corporation" in paragraph 59(3.4)(a) has been amended to provide for the acquisition of property from any person, not just a corporation; and the expression "predecessor corporation" in subsection 59(3.3) has been replaced by the expression "predecessor".

Further changes add a reference to subsection 66.4(3) in paragraph 59(3.4)(a) and a reference to subsection 66.4(4) in paragraph 59(3.4)(b). The effect of these changes is to clarify that the definitions "successor corporation" and "second successor corporation" include corporations that are successor corporations and second successor corporations by virtue of elections made under the successor and second successor rules for Canadian oil and gas property expenses.

The new paragraph 59(3.4)(c) is consequential upon the addition of new paragraph 59(3.3)(f) of the Act. The new paragraph 59(3.3)(f) requires an income inclusion in respect of the recovery of mining exploration expenses that earned depletion for the taxpayer or a specified predecessor of the taxpayer. The new paragraph 59(3.4)(c) defines a specified predecessor of the taxpayer. In effect, a specified predecessor of a taxpayer includes the immediate and all previous predecessors of the taxpayer.

These amendments are applicable in respect of acquisitions of property after April 19, 1983.

Subclause 25(5)

ITA 59(6)

Subsection 59(6) of the Act provides that certain terms used in section 59 have the meanings assigned by regulations made for the purposes of section 65. The amendment to subsection 59(6) adds "mining exploration depletion base" to the list of terms that may be defined by regulation. This amendment is consequential on the addition of new paragraph 59(3.3)(f) and is applicable after April 19, 1983.

Subclauses 25(6) and (7)

These set out the effective dates for the amendments to section 59 of the Act.

Clause 26

Subclause 26(1)

ITA
63(1), (2) and (2.1)

Section 63 of the Act provides the deduction for child care expenses. A number of significant amendments are being made effective for the 1983 and subsequent taxation years.

The amendments to subsection 63(1) double the amount of the child care expense deduction to $2,000 per eligible child and $8,000 per family. In addition, they remove differences in the qualifications for the deduction depending on the sex of the taxpayer. Under subsection 63(1) as amended, the amount of the deduction claimed by a taxpayer in respect of a child must be reduced by the child care expenses claimed by any other person providing support for that child.

Where two or more taxpayers contributed to the support of an eligible child, the deduction must generally be claimed by the taxpayer with the lower income. However, in the circumstances specified in paragraph 63(2)(b) of the Act, the supporting individual with the higher income may claim a deduction based on the number of weeks in the year throughout which the lower-income individual is separated, infirm, confined to a bed or a wheelchair, in prison or in full-time attendance at a designated educational institution. The lower-income individual's claim is then reduced accordingly.

Under subsection 63(2) the child care expense deduction must generally be claimed by the supporting individual with the lower income. Subsection 63(2.1) provides that where the incomes of two supporting persons are equal, a deduction will be allowed only if the two jointly elect which of them may claim it.

Subclauses 26(2) to (5)

ITA
63(3)(a)

Paragraph 63(3)(a) of the Act defines "child care expense". Certain technical changes are required to this definition because of the doubling of the deduction and the limitation of the deduction in many circumstances to the lower-income supporting individual. The amount deductible in respect of a period during which an eligible child is at a boarding school or camp is increased from $30 to $60 a week. In addition, it is no longer required that an eligible child be in the custody of the person claiming the child care deduction. Child care expenses will now qualify for a deduction by a taxpayer in any case where the expenses relate to an eligible child of the taxpayer (as defined in paragraph 63(3)(c)) and are incurred either by the taxpayer or by any other supporting person (as defined in paragraph 63(3)(d)) of the child.

Subclause 26(6)

ITA
63(3)(c) and (d)

Paragraphs 63(3)(c) and (d) have been added to define the terms "eligible child" and "supporting person" for the purpose of the child care expense deduction. An "eligible child" of a taxpayer will include a child of the taxpayer or his spouse and any child in respect of whom the taxpayer claimed a dependants' deduction under section 109 of the Act. For this purpose a child will cease to be eligible in the year in which he becomes 15 years of age unless he remains dependent by reason of mental or physical infirmity. The definition of a supporting person is necessary because of the restriction of the deduction for child care expenses to the taxpayer with the lower income. A "supporting person" of an eligible child of a taxpayer in a taxation year includes only those persons enumerated in paragraph 63(2)(d) who resided with the taxpayer at some time during the year and within the 60-day period following the end of the year.

Subclause 26(7)

ITA 63(4)

Under the existing provisions relating to child care expenses, a deduction is available only if the child is in the custody of the taxpayer. This requirement is no longer relevant and thus subsection 63(4) of the Act is repealed.

Subclause 26(8)

This sets out the effective date for the amendments to section 63 of the Act relating to child care expenses.

Child Care Expenses

ITA
63.1(c) and (e)

Clause 27

Section 63.1 of the Act extends the application of the provisions covering child care expenses to certain government employees and other persons outside Canada who are treated, under section 250 of the Act, as residents of Canada. This is achieved by permitting such persons to claim child care expenses incurred outside Canada. The amendments to this section are strictly consequential on the amendments to section 63 relating to the child care expense deduction. They are effective for the 1983 and subsequent taxation years.

Exploration and Development Expenses

Clause 28

Subclauses 28(1) to (4)

ITA 66(6) and (7)

The Act provides successor rules that allow the unused exploration, development or resource property expenses of one corporation to be deducted by a "successor" corporation which acquires all or substantially all its resource assets. The expenses that are passed on to a successor corporation or second successor corporation may be deducted only against resource income from assets acquired from the original transferor. The successor rules are contained in subsections 66(6) and (7), 66.1(4) and (5), 66.2(3) and (4), and 66.4(3) and (4) of the Act.

The amendments to subsections 66(6) and (7) of the Act expand the existing successor rules by dropping the requirement that the transferor be a corporation. As a result, the successor rules will now also be available in the case where an individual or other person transfers all or substantially all of his resource assets to a corporation. These amendments are applicable to property acquired by a successor corporation from a predecessor after April 19, 1983.

(Note that similar amendments are made to subsections 29(25) and (29) of the Income Tax Application Rules, 1971 which apply in respect of similar expenses incurred before 1972).

Subclause 28(5)

ITA 66(10.1), (10.2) and (10.3)

Subsections 66(10.1) to (10.3) of the Act allow a joint exploration corporation to renounce all or any portion of its Canadian exploration, Canadian development and Canadian oil and gas property expenses in favour of one or more of its shareholder corporations, thereby transferring the deductibility of these expenses to the shareholder corporation.

The principal amendments to subsections 66(10.1) to (10.3) provide that a joint exploration corporation may renounce these expenses only to the extent they exceed any related government assistance or benefits—such as grants under the Petroleum Incentives Program Act. These amendments are effective with respect to Canadian exploration and development expenses incurred by a joint exploration corporation after March 16, 1983, other than those incurred before October, 1984 in respect of which payments or loans were made to the corporation by a shareholder corporation pursuant to arrangements which were substantially advanced and evidenced in writing on or before March 16, 1983.

A joint exploration corporation that wishes to renounce expenses in respect of a taxation year must elect to renounce the expenses during the year or within 6 months following the year end. The expenses renounced by the joint exploration corporation are deducted from its relevant cumulative expense account. Subsections 66(10.1) to (10.3) are also amended to clarify that the renounced expenses in respect of a year are to be deducted from the joint exploration corporation's cumulative expense accounts at the earlier of the time of renouncement and immediately before the year end. These amendments are applicable with respect to amounts renounced after April 19, 1983.

Expenses renounced by a joint exploration corporation in a year are considered to have been incurred by a shareholder corporation during its taxation year in which the year of the joint exploration corporation ends. Subsections 66(10.1) to (10.3) are also amended to provide that where a shareholder corporation has no taxation year in which the particular taxation year of the joint exploration ends (for example, because the shareholder corporation has been wound-up) the renounced expenses will be deemed to have been incurred by the shareholder corporation during its last taxation year. These amendments are applicable in respect of expenses renounced after December 31, 1982.

ITA
66(10.4)

When a shareholder corporation makes a payment or loan to a joint exploration corporation in respect of expenses that are to be renounced, the shareholder corporation may receive capital property or other property from the joint exploration corporation as consideration for the payment or loan. Where the property so received is capital property, new subsection 66(10.4) requires the renounced expenses to be deducted in computing the adjusted cost base to the shareholder corporation of the property. Where another property is substituted for such capital property before expenses are renounced, the expenses are deducted in computing the adjusted cost base of the substituted property when renunciation occurs. In the remaining case, where the shareholder corporation no longer owns the property at the time that the expenses are renounced, any renounced expenses that have not been deducted in computing the adjusted cost base of the capital property or substituted property are deemed to be a capital gain of the shareholder corporation.

Where the property received by the shareholder corporation in consideration for a payment or loan is capital property, subsection 66(10.4) requires the renounced expenses to be deducted in computing the cost of the property to the shareholder corporation. Any renunciation of expenses after the property has been disposed of will be included in the income of the shareholder corporation.

A shareholder corporation may also make a payment to a joint exploration corporation that is a contribution to the capital of the corporation. In that case, paragraph 53(2)(f.1) of the Act requires the amount of renounced expenses to be deducted in computing the adjusted cost base of any shares of the joint exploration corporation that are capital property then held by the shareholder corporation. Any renounced expenses not so deducted are required under subsection 66(10.4) and new paragraph 59(3.2)(e) of the Act to be included in the income of the shareholder corporation.

New subsection 66(10.4) is applicable in respect of renounced expenses that relate to payments or loans made by a shareholder corporation to a joint exploration corporation after April 19, 1983.

Subclauses 28(6) and (7)

ITA
66(11.1) and (11.2)

Subsection 66(11.1) of the Act provides that the successor rules apply to a corporation in the resource sector if the corporation ceases to be tax exempt or if its control changes. The purpose of making the successor rules apply is to restrict the deductibility of the corporation's exploration and development expenses incurred before the change of control or the change in tax status. These expenses are subsequently deductible but only to the extent of the corporation's resource income from assets held by it immediately before the change. If the corporation later transfers all or substantially all of its resource assets to another corporation so that the successor rules again apply, subsection 66(11.2) provides that the corporation acquiring those assets will itself be subject to the same restrictions that applied to the original corporation with respect to the deduction of its expenses.

Consequential amendments applicable after April 19, 1983 are made to subsections 66(11.1) and (11.2) to relfect the expansion of the successor rules described in the note on subclauses 28(1) to (4).

A further amendment adds new paragraph 66(11.1)(f) to provide that, in computing the income of a corporation for its taxation year during which a change in control occurred, the exploration and development expenses made or incurred by the corporation before that time may be deducted from certain income in addition to the income referred to in the successor rules. Such additional income consists of the income of the corporation for the year from the disposition of resource properties before the change of control and includes any production revenue from those properties. New paragraph 66(11.1)(f) is a relieving amendment and is applicable to taxation years ending after November 12, 1981.

Subclause 28(8)

ITA
66(15)(a)(i)

Paragraph 66(15)(a) of the Act defines "agreed portion". This definition is used in subsections 66(10) to (10.3) of the Act which allow a joint exploration corporation to renounce all or a portion of its Canadian exploration and development expenses in favour of one or more shareholder corporations. For these provisions to apply, the shareholder corporation must make payments to the joint exploration corporation in respect of such expenses incurred or to be incurred by the joint exploration corporation. This amendment, applicable to the 1982 and subsequent taxation years, clarifies that loans will be considered to be payments made by a shareholder corporation to a joint exploration corporation for the purposes of these provisions.

Subclause 28(9)

ITA
66(15)(g.3)

Under paragraph 98(3)(d) of the Act, a designated amount can be added to the cost of resource property acquired by a partner on the dissolution of a partnership. Paragraph 98(5)(d) contains a similar rule which allows a designated amount to be added to the cost of a resource property acquired by a partner who carries on as a sole proprietor the business that was previously carried on by a partnership.

Paragraph 66(15)(g.3) of the Act clarifies that an amount so designated under paragraph 98(3)(d) will be regarded as an "outlay" or "expense" made or incurred by the partners for purposes of sections 66, 66.1, 66.2 and 66.4 of the Act. The amendment to paragraph 66(15)(g.3) ensures that similar treatment applies for an amount designated under paragraph 98(5)(d). This amendment is applicable after 1980.

Subclause 28(10)

ITA
66(15)(i)(ii)

Paragraph 66(15)(i) of the Act defines a "shareholder corporation" for the purposes of subsections 66(10) to (10.3) of the Act. Those subsections allow a joint exploration corporation to renounce a portion of its Canadian exploration and development expenses in favour of one or more shareholder corporations. For those provisions to apply, the shareholder corporation must make payments to the joint exploration corporation in respect of such expenses incurred by the joint exploration corporation. The amendment to subparagraph 66(15)(i)(ii) clarifies that a loan will be considered to be a payment for the purpose of these provisions.

The definition "shareholder corporation" is also amended to clarify that a payment or loan may be made in respect of expenses to be incurred as well as in respect of expenses which have been incurred.

The amendments to paragraph 66(15)(i) are applicable with respect to the 1982 and subsequent taxation years.

Subclauses 28(11) to (14)

These set out the effective dates for the amendments to section 66.

Successor Corporation's Canadian Exploration Expense
ITA
66.1(4)
66.1(5)

Clause 29

Subsection 66.1(4) and (5) contain the successor rules that apply to the deduction of Canadian exploration expenses. Amendments to section 66 of the Act extend the successor rules so that they apply where a corporation acquires all or substantially all of the property used by an individual in carrying on his resource businesses and the individual and the corporation elect to have the rules apply. The existing rules apply only where the property is acquired from a corporation. The amendments to subsections 66.1(4) and (5) of the Act implement the extension of the successor rules for Canadian exploration expenses where the predecessor is an individual. The amendments are applicable with respect to property acquisitions by a successor corporation from a predecessor after April 19, 1983.

Successor Corporation's Canadian Development Expenses

Clause 30

Subclauses 30(1), (2) and (4)

ITA 66.2(3) to (5)

Subsections 66.2(3) to (5) of the Act contain the successor rules that apply to the deduction of Canadian development expenses. Amendments to section 66 of the Act extend the successor rules so that they apply where a corporation acquires all or substantially all of the property used by an individual in carrying on his resource businesses and the individual and the corporation elect to have the rules apply. The existing rules apply only where the property is acquired from a corporation. The amendments to subsection 66.2(3) to (5) extend the successor rules for Canadian development expenses where the predecessor is an individual. The amendments are applicable with respect to property acquisitions by a successor corporation from a predecessor after April 19, 1983.

Subclause 30(3)

ITA 66.2(5)(a)(i)(C)

An outlay or expense incurred by a taxpayer in drilling or converting a well in Canada for the injection of water or gas to assist in the recovery of petroleum or natural gas from another well is defined by clause 66.2(5)(a)(i)(C) of the Act as a Canadian development expense. The amendment to this clause provides that an expense incurred in drilling such an injection well will qualify as a Canadian development expense irrespective of the nature of the injected substance. This amendment is effective for expenses incurred after 1980.

Subclauses 30(5) and (6)

These set out the effective dates for the amendments to section 66.2 of the Act.

Successor Corporation's Canadian Oil and Gas Property Expense
ITA
66.4

Clause 31

Subsections 66.4(3) and (4) of the Act contain the successor rules that apply to the deduction of Canadian oil and gas property expenses. Amendments to section 66 of the Act extend the successor rules so that they will apply where a corporation acquires all or substantially all of the property used by an individual in carrying on his resource business and the individual and the corporation elect to have the rules apply. The existing rules apply only where the property is acquired from a corporation. The amendments to section 66.4 of the Act implement the extension of the successor rules for Canadian oil and gas property expenses where the predecessor is an individual or other person. The amendments are applicable with respect to property acquisitions by a successor corporation from a predecessor after April 19, 1983.

Aviation Turbine Fuel

ITA
69(7.1) and
69(11)

Clause 32

Subsection 69(7.1) of the Act requires a vendor of aviation turbine fuel used on an international flight to include a prescribed amount in income in addition to the actual sale proceeds. Subsection 69(11) sets out rules to establish the circumstances in which fuel is deemed to be used on an international flight for the purposes of subsection 69(7.1). This clause repeals subsections 69(7.1) and (11) effective with respect to dispositions of aviation turbine fuel after April 30, 1983.

Deceased Taxpayer

Clause 33

Subclause 33(1)

ITA 70(2)

Under subsection 70(2) of the Act, the value of "rights or things" owned by a taxpayer at his death is required to be included in his income for his final taxation year. This subsection is amended to exclude a security owned under an indexed security investment plan from the meaning of a right or thing.

Subclause 33(2)

ITA 70(5.3)

Subsection 70(5.3) of the Act stipulates that, where a share of a corporation is deemed to have been disposed of immediately before the death of an individual for proceeds equal to its fair market value at that time, such fair market value shall be determined as though the value of any life insurance policy on the life of the deceased was equal to its cash surrender value at that time. The amendment ensures that, for deaths occurring after December 1, 1982, cash surrender value shall be determined without regard to any policy loans outstanding or any dividends (or interest thereon) payable under the policy. This is accomplished by referring to the definition of cash surrender value in paragraph 148(9)(b) of the Act.

ITA 70(5.4)

Under subsection 70(5) of the Act, a taxpayer is treated as having disposed immediately before his death of any capital property owned by him at that time. New subsection 70(5.4) sets out rules that will apply where a taxpayer who is, or was previously, a participant under an indexed security investment plan dies in the year. As a general rule, each security owned under an existing plan is deemed to have been disposed of immediately before the taxpayer's death for proceeds equal to its fair market value at that time and each put or call option written under the plan outstanding at the time of the taxpayer's death is deemed to be closed out immediately before his death at the amount it would cost to close out such option on a prescribed stock exchange in Canada.

The deceased's capital gain or capital loss for the year from the plan is the amount that would otherwise have been his gain or loss for the year from the plan; that is, there will be no amortization of gains and losses in the year of death. Where the deceased had previously terminated an indexed security investment plan, any capital loss that would otherwise have been amortized under the rules set out in subsection 47.1(10) will be treated as a capital loss from the plan for the year of death. Any person who has acquired a security that was owned by a deceased under an indexed security investment plan is deemed to have acquired it at a cost equal to its fair market value immediately before the death of the taxpayer. In addition, any person who assumes the obligation in respect of a put or call option written under the deceased's plan is deemed to have written the option immediately after the death of the taxpayer for proceeds equal to the amount the deceased would have had to pay if he had closed out the option on a prescribed stock exchange in Canada.

Under paragraph 70(5.4)(g), the rules described above will not apply in certain circumstances with respect to deaths occuring after September 30, 1983. Subsection 70(6) of the Act permits capital property to be transferred or distributed on death to a spouse or qualifying spousal trust on a tax-deferred "rollover" basis. Paragraph 70(5.4)(g) extends the rollover to securities owned and put and call options written under an indexed security investment plan if three conditions are met. First, all securities owned under the plan must be transferred to, and all put and call options written under the plan and outstanding at the time of the taxpayer's death must be assumed by, the deceased's spouse or a qualifying spousal trust as a result either of his death or of a disclaimer or renunciation by a beneficiary under his will or intestacy. Second, all the deceased's rights and obligations under the plan must be transferred to or assumed by the spouse or qualifying spousal trust. Third, it can be established that the first two conditions are satisfied within 15 months of the taxpayer's death or such longer period as is reasonable in the circumstances. Where these requirements are met, the spouse or qualifying spousal trust will, in effect, become the participant under the deceased's plan at the date of death on a "rollover" basis and the deceased's capital gain or loss from the plan for the year of death will be deemed to be nil.

Subclause 33(3)

ITA
70(10)(b)

Paragraph 70(10)(b) of the Act provides a definition of the expression "share of the capital stock of a family farm corporation". This definition is relevant for the purpose of the special rollover rules provided in sections 70 and 73 on the transfer of a family farm by a taxpayer to a child. The definition is extended to include the shares of a holding corporation where all or substantially all of the property of the corporation is shares or debt obligations of farm corporations involving the same family.

The amendment is effective for transfers of such shares made after May 25, 1978. This is the date that the corresponding provision, paragraph 70(11)(c) of the Act, relating to small business corporations was extended to holding companies.

Subclauses 33(4) to (6)

These set out the effective dates for the amendments to section 70 of the Act.

Transfers to Spouse

Clause 34

Section 74 of the Act contains what are generally referred to as attribution rules. Under these rules any income, gains and losses arising from property transferred between married individuals is attributed to the spouse who originally owned the property. The amendments to this section are consequential on the introduction of the indexed security investment plan.

Subclause 34 (1)

ITA 74(2)(f)

Subsection 74(2) provides that a taxable capital gain or allowable capital loss realized on a disposition of property previously transferred to the spouse of a taxpayer is treated as a taxable capital gain or allowable capital loss of the taxpayer and not of the spouse. Paragraph 74(2)(f) provides a similar rule with respect to indexed security investment plans. After September 30, 1983, any part of a capital gain or loss from an indexed security investment plan that can reasonably be considered to relate to property transferred between spouses or property substituted therefor will be attributed to the original owner as long as he is resident in Canada and the transferee is his spouse.

Subclause 34 (2)

ITA 74(7)(b)

Paragraph 74(7)(b) of the Act provides an exception to the attribution of taxable capital gains and allowable capital losses where the spouses are separated pursuant to a decree, order or judgment of a competent tribunal or a written agreement and the original owner and his spouse jointly elect not to have the attribution rules apply. The amendment to paragraph 74(7)(b) adds any part of a capital gain or loss from an indexed security investment plan that may reasonably be considered to relate to a period when the spouses were separated to the exception from the attribution rules.

Subclause 34 (3)

This sets out the effective date for the amendments to section 74 of the Act.

Trusts

ITA
75(2)

Clause 35

Subsection 75(2) provides attribution rules in respect of property transferred to certain trusts, commonly known as "reversionary trusts". This amendment, effective October 1, 1983, provides that any capital gain or capital loss of a reversionary trust from an indexed security investment plan that may reasonably be considered to be derived from property transferred to the trust or property substituted therefor will be attributed to the transferor during his lifetime while he is a resident of Canada.

Debtor's Gain on Settlement of Debts
ITA
80(1)(a)

Clause 36

Section 80 of the Act sets out the rules that apply where a taxpayer's debt is settled or extinguished for less than its principal amount. In most circumstances the resulting gain is not immediately taxable to the debtor but rather reduces in turn the amount of his deductible loss carryovers from preceding taxation years, the capital cost of his depreciable property and the adjusted cost base of any other capital property.

The amendment to paragraph 80(1)(a) is consequential on the introduction of the new "farm loss" carryover in paragraph 111(1)(d) which extends the period over which losses incurred in farming and fishing businesses may be claimed. As a result of this amendment, the gain to which the rules in section 80 apply reduces, in order, the debtor's non-capital losses, farm losses, net capital losses and restricted farm losses for preceding taxation years to the extent of the amount of those losses that would otherwise be deductible in computing taxable income for the current or a subsequent taxation year. This addition of a reference to farm losses in section 80 is applicable to the 1983 and subsequent taxation years.

Cross Reference

ITA 80(3)

The time for filing an election specified in subsection 80(3) on the winding-up of a corporation is extended by clause 111 (see commentary thereunder).

Cross Reference

ITA 80.4

The coming into force provision governing recent changes to section 80.4 relating to interest on shareholder and employee loans is amended by clause 112 (see commentary thereunder).

Deemed Interest Expense
ITA
80.5

Clause 37

Section 80.5 of the Act provides that where a benefit is included in the income of a taxpayer under section 80.4 in respect of employee or shareholder debt, the amount of the benefit will be treated as interest expenses of the debtor for the purposes of the rules in paragraph 20(1)(c) of the Act relating to the deduction of interest. As a result, the taxpayer will generally obtain an offsetting deduction in those circumstances where the borrowed money is invested or used in a business.

Under subparagraph 8(1)(j)(i) of the Act, employees are permitted to deduct interest on funds borrowed to buy an automobile or an aircraft if they are eligible to deduct expenses under either the salesmen's or travel expense provisions. This amendment to section 80.5 allows these employees to treat any section 80.4 benefit as interest expense for the purpose of the deduction under subparagraph 8(1)(j)(i) of the Act. Generally speaking, this means that employees who require a car in their employment and otherwise meet the criteria of paragraph 8(1)(f) or (h) of the Act will have no net benefit under section 80.4 where the employer provides a low-interest or interest-free loan for the car.

This amendment applies to taxation years commencing after 1981 when section 80.5 became effective.

Cross Reference

ITA 80.5

A new transitional rule governing the introduction of section 80.5 concerning the deductibility of section 80.4 deemed interest is provided by clause 113 (see commentary thereunder).

Deemed Dividends

Clause 38

ITA
84(8)

Under subsections 84(1) to (4) of the Act, a shareholder is deemed to receive a dividend as a result of certain corporate transactions, except where section 84(8) overrides to treat the distribution as proceeds of disposition of a share. Subsection 84(8) is amended effective October 1, 1983 to treat a deemed dividend on a share of a corporation as proceeds of disposition where the shareholder was not dealing at arm's length with the corporation and the share is owned under an indexed security investment plan. As a result, the amount will reduce the indexing base of the plan in accordance with subparagraph 47.1(4)(a)(iv).

Amalgamations

Clause 39

Subclause 39(1)

ITA 87(1.2)(a)(ii)

Subsection 87(1.2) of the Act sets out the treatment in an amalgamated corporation of various types of resource expenses incurred by its predecessor corporations. Subparagraph 87(1.2)(a)(ii) is amended to replace the references therein to "predecessor corporation" by a reference to "predecessor" as a consequence of the amendments to the successor rules. This amendment is applicable with respect to acquisitions of property by a successor corporation from a predecessor after April 19, 1983.

Subclause 39(2)

ITA 89(2)(j)

Both paragraph 20(1)(m.1) of the Act and new paragraph 20(1)(m.2) of the Act allow deductions by a taxpayer in respect of amounts previously included in the income of the taxpayer under paragraph 12(1)(a) of the Act. The amendment to paragraph 87(2)(j) of the Act allows a new corporation formed on an amalgamation to make deductions under paragraphs 20(1)(m.1) and (m.2) in respect of amounts previously included in the income of a predecessor corporation under paragraph 12(1)(a) as though those amounts had been previously included in the income of the new corporation. This amendment applies to the 1979 and subsequent taxation years of a new corporation.

Subclause 39(3)

ITA 87(2)(w)

Section 87 of the Act deals with amalgamations of corporations. On an amalgamation of two or more taxable Canadian corporations, the tax positions of the predecessor corporations are for the most part maintained in the amalgamated corporation. Paragraph 87(2)(w) of the present Act provides an exception to this general rule by denying the amalgamated corporation any deduction in respect of its predecessors' unclaimed restricted farm losses—that is, the undeducted losses from a farming business which was not the predecessor's chief source of income. Paragraph 87(2)(w) is repealed in respect of amalgamations occurring after 1982 with the result that restricted farm losses will be able to flow through on an amalgamation under subsection 87(2.1), as amended.

Subclause 39(4)

ITA 87(2)(nn) and (oo)

Subsection 87(2) of the Act provides rules which apply on the amalgamation of two or more taxable Canadian corporations. The amalgamated corporation is generally treated as a continuation of its predecessor corporations for the purposes of the Act. The new paragraphs 87(2)(nn) and (oo) are added as a consequence of the introduction of the new refundable taxes under Part VII and Part VIII relating to share-purchase and scientific research tax credits. These paragraphs provide that any Part VII tax or Part VIII tax paid by a predecessor corporation which has not been refunded to it will be treated as having been paid by the amalgamated corporation. Thus a new corporation formed on an amalgamation will be entitled to offset the Part VII tax paid by a predecessor corporation by any share-purchase or investment tax credit earned by the new corporation and to offset any Part VIII tax paid by a predecessor corporation by renounced scientific research expenditures of the new corporation. These amendments apply to the 1983 and subsequent taxation years.

Subclause 39(5)

ITA 87(2.1)

Subsection 87(2.1) of the Act permits an amalgamated corporation to deduct the unclaimed non-capital and net capital losses of its predecessor corporations. This subsection is amended as a consequence of the introduction of the new provisions relating to farm loss carryovers in section 111 of the Act. This amendment is necessary to permit an amalgamated corporation to continue to claim the unabsorbed farm losses of its predecessor corporations. The amendment to subsection 87(2.1) also introduces a similar "flow-through" of restricted farm losses on an amalgamation. The amendments to subsection 87(2.1) apply to amalgamations occurring after 1982.

Subclauses 39(6) to (9)

These set out the effective dates for the amendments to section 87 of the Act relating to amalgamations.

Winding-up of a Corporation

Clause 40

Subclause 40(1)

ITA
88(1)(d.2)

Section 88 of the Act sets out rules that apply on the winding-up of a corporation. Paragraph 88(1)(d.2) provides rules for determining when control of a subsidiary has been acquired for the purpose of the winding-up provisions. These rules are designed to restrict an increase in the cost base of the underlying property of the subsidiary for tax purposes through the transfer of its control between persons not dealing at arm's length.

A recent amendment to paragraph 88(1)(d.2), applicable to windings-up commencing after November 12, 1981, replaced a reference to the acquisition of "control" with a reference to the acquisition of a "share" to clarify that the rules would apply where control was acquired from a group of persons. The amendment had implications which are avoided by replacing the reference to the acquisition of a share by a reference to a non-arm's length acquisition of control from a person or group of persons.

In corporate takeovers, the acquiring corporation will often have a right to purchase the shares of a target corporation before the acquisition occurs. Under paragraph 251(5)(b) of the Act, a person who holds a right to acquire, or to control the voting rights of, shares of a corporation is treated as owning the shares. This may result in the acquiring corporation being treated as controlling the target corporation and therefore as not dealing at arm's length with those persons from whom it is purchasing the shares. It is inappropriate for an unrelated purchaser and vendor of the shares in these circumstances to be treated as not dealing at arm's length simply because of the existence of a right. The amendment to paragraph 88(1)(d.2), applicable to windings-up commencing after November 12, 1981, corrects this problem.

Subclauses 40(2) and (3)

ITA
88(1)(e.2)
88(1)(e.2)(xvii)
to (xx)

Subsection 88(1) of the Act sets out detailed 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 amendments to paragraph 88(1)(e.2) make reference to new paragraphs 87(2)(nn) and (oo) which deal with the new share-purchase and scientific research tax credits. The effect is to enable a parent corporation to obtain a refund of the Part VII and Part VIII tax paid by its subsidiary before the winding-up through the subsequent offset of the parent's share-purchase tax credits, investment tax credits or renounced scientific research expenditures. These amendments are applicable to the 1983 and subsequent taxation years.

Subclauses 40(4) and (5)

ITA
88(1.1) and (1.2)

Subsection 88(1.1) of the present Act permits a parent corporation to utilize the non-capital losses of a subsidiary which has been wound up where the parent owned at least 90 per cent of the subsidiary's issued shares. This provision is amended strictly as a consequence of the introduction of the new farm loss carryover in section 111 of the Act. The amendment is necessary to permit a parent corporation to continue to claim the farm losses of a subsidiary following a winding-up. The amendment also extends the flow-through to a parent company of restricted farm losses on a winding-up of a subsidiary.

Under amended section 111, a taxpayer is no longer required to claim the maximum loss carryover in the earliest year in which it is deductible, but rather may deduct whatever portion of any loss he may choose and defer the balance for deduction in any later year in the carryover period. This change to the loss rules requires amendments to subsections 88(1.1) and (1.2) which provide for the flow-through of losses on a winding-up. As amended, these subsections provide for the availability to a parent corporation of a subsidiary's losses which were not "deducted" rather than those that were not "deductible".

These amendments apply to windings-up commencing in the 1983 and subsequent taxation years.

Subclause 40(6)

ITA
88(1.3)

Where there has been a winding-up of a subsidiary corporation, subsections 88(1.1) and (1.2) of the Act treat the deductible losses of the subsidiary as losses of its parent corporation for the taxation year of the parent in which the subsidiary's loss year ended. Subsection 88(1.3) deals with the case where the parent corporation was incorporated or otherwise formed after the end of a loss year of the subsidiary. In this case, subsection 88(1.3) treats the parent as having been in existence from the end of the loss year and as having been controlled throughout this period by the person or group of persons who controlled it immediately after its incorporation. This provision is amended, effective for windings-up commencing after the 1982 taxation year, to clarify that the rules in subsection 88(1.3) apply not only where the parent corporation was incorporated after the end of the subsidiary's loss year, but also where the parent might have come into existence by way of an amalgamation or otherwise.

Subclauses 40(7) to (9)

These set out the effective dates for the amendments to section 88 of the Act relating to windings-up.

Capital Dividend Account
ITA
89(1)(b)(i)(A)(II)
and (B)(II)

Clause 41

Paragraph 89(1)(b) of the Act defines "capital dividend account". This account is an integral part of the mechanism for allowing capital gains to flow through a private corporation without attracting an extra level of tax. The non-taxable half of a capital gain realized by a private corporation is added to its capital dividend account from which dividends may be received tax-free by its shareholders. Subparagraph 89(1)(b)(i) provides that the portion of a capital gain or loss that accrued while the property disposed of was held by a non-private corporation is excluded from the capital dividend account. This exclusion would apply where a private corporation disposes of capital property which it owned during a period of time when it was non-private or which it acquired from a non-private corporation on a tax-deferred "rollover" basis. The amendments to subclauses 89(1)(b)(i)(A)(II) and (B)(II) provide that the amount of such gains or losses which accrued while the property disposed of was owned by an investment corporation, a mortgage investment corporation or a mutual fund corporation will be included in the computation of the capital dividend account. These amendments are applicable to dispositions occurring after November 12, 1981.

Non-Resident Trusts

ITA
94(2)

Clause 42

Section 94 of the Act contains special rules for the taxation of certain non-resident trusts. The amendments to subsection 94(2) change the references therein and are strictly consequential on the amendments in Bill C-139 in which subparagraph 94(1)(b)(i) and (ii) were restated as clauses 94(1)(b)(i)(A) and (B). The amendments are effective for taxation years of trusts commencing after November 12, 1981.

Excluded Property

ITA
95(1)(a.1)

Clause 43

Paragraph 95(1)(a.1) of the Act defines the meaning of the term "excluded property", for the purposes of the provisions relating to foreign affiliates. This paragraph also provides that where a foreign affiliate of a taxpayer has an interest as partner of at least 10 per cent in a partnership, the partnership shall be deemed to be a foreign affiliate of the taxpayer. The amendment to this paragraph specifies that an interest in a partnership that qualifies as a foreign affiliate of a taxpayer shall be deemed to represent shares of the capital stock of a foreign affiliate. This is necessary to ensure that where the interest is disposed of it will be treated as a disposition of excluded property provided that all or substantially all of the partnership property is itself excluded property, for example active business assets. As such, the disposition will not give rise to foreign accrual property income. This amendment is effective after November 12, 1981.

Partnerships

ITA
96(1)

Clause 44

Subsection 96(1) of the Act requires that the income earned and losses incurred by a partnership be calculated at the partnership level and be attributed to partners in accordance with their respective interests. Thus, the appropriate share of partnership income and losses is included in the calculation of each member's income, net capital loss, non-capital loss, restricted farm loss and taxable income. This provision is amended for the 1983 and subsequent taxation years to add a reference of the "farm loss" of a partner. A farm loss is a separate category of business loss introduced in section 111 and the amendment to section 96 is strictly consequently on this segregation of farm losses out of non-capital losses.

Restricted Farm Losses
ITA
101(b)

Clause 45

Paragraph 53(1)(i) of the Act provides a special rule for a taxpayer who has had a restricted farm loss and disposes of his farm land at a gain. In these circumstances, a portion of the undeducted restricted farm losses is added to the adjusted cost base of the property for the purposes of determining the amount of the capital gain. Section 101 of the Act provides a corresponding rule where the farm land is disposed of by a partnership. In this case, the intended reduction in the capital gain is achieved by allowing each partner to deduct from income one-half of his share of any restricted farm losses of the partnership and of any property taxes paid by the partnership on farm land that were not previously deducted by the partner. The deduction to the partner is limited to the extent of his share of the partnership's capital gain from the disposition of the farm land.

Under section 111 as amended, a taxpayer is no longer required to claim a restricted farm loss carryover in the earliest year in which it may be deducted, but instead may preserve the loss to be carried forward to later years in the carryover period. The amendment to paragraph 101(b) of the Act is strictly consequential on this greater flexibility in determining the amount and timing of loss carryover deductions. The paragraph is amended, applicable to the 1983 and subsequent taxation years, to refer to restricted farm losses which were not "deducted" rather than those which were not "deductible".

Clause 46

Subclause 46(1)

ITA
104(3)

Subsection 104(3) of the Act denies trusts the right to deduct either personal exemptions or the $100 optional standard deduction. The amendment to the subsection is strictly consequential on the repeal of the $100 optional standard deduction. It removes the reference to that deduction effective for the 1984 and subsequent taxation years.

Subclause 46(2)

ITA
104(5.1)

Subsections 104(4) and (5) of the Act treat a trust as having disposed of certain of its property at fair market value on stated days—generally every 21 years.

New subsection 104(5.1) complements subsections 104(4) and (5) where the trust is, or was previously, a participant under an indexed security investment plan. For the purposes only of computing a trust's capital gain or capital loss from such a plan for a taxation year that includes a stated day, subparagraph 104(5.1)(a) deems the trust's taxation year to end on that stated day and a new taxation year to commence immediately thereafter. All indexed securities owned under an existing plan are deemed to have been disposed of before the end of this special year at their fair market value and to have been reacquired at that amount at the beginning of the new taxation year. All put and call options written under an existing plan and outstanding at the end of this year are deemed to have been closed out before the end of this special year at the amount it would cost to close out such option at that time on a prescribed stock exchange in Canada and to have been rewritten at that amount at the beginning of the new taxation year. The result is an immediate acceleration of all capital gains and losses from the plan in the year.

New paragraph 104(5.1)(b) provides that where the trust was a participant under an indexed security investment plan which had previously been terminated and the capital losses from the plan are being amortized in accordance with the provisions of subsection 47.1(10) when the special taxation year ends, the trust will be treated as having a capital loss for the year equal to the total of all amounts that would otherwise be its capital losses from the plan for that year and subsequent years. The result is an acceleration of the deduction for all capital losses from all previously terminated plans.

Subclause 46(3)

ITA
104(6)(b)

Subsection 104(6) of the Act permits a trust to deduct in a year any income payable in the year to a beneficiary. However, a spousal trust cannot deduct taxable capital gains payable to a beneficiary where the gains arose as a result of a deemed disposition of property under subsection 104(4), (5) or 107(4) of the Act. Under the amendment to paragraph 104(6)(b), the trust will not be permitted any deduction for taxable capital gains under an indexed security investment plan payable to a beneficiary which arose as a result of a deemed disposition under new subsection 104(5.1). Accordingly, such taxable capital gains will be taxed as income of the spousal trust rather than as income of the beneficiaries.

Subclause 46(4)

ITA 104(8)

Subsection 104(8) of the Act prohibits a trust from deducting certain income payable in a year to its beneficiaries. Generally the trust may not deduct income on which a non-resident beneficiary would be taxable under Part I of the Act if he earned the income directly or, where trust is a qualifying spousal trust, income arising as a result of the application of subsection 104(4), (5) or 107(4). The result is that such income is taxed in the hands of the trust and is not again taxed when distributed.

Subsection 104(8) is amended in three respects. First, it is amended to apply where a qualifying spousal trust that is a participant under an indexed security investment plan has a taxable capital gain from the plan as a result of a deemed disposition of securities under new subsection 104(5.1). Second, the subsection is amended to correct a technical deficiency that may result in circular computations where a preferred beneficiary election is made in respect of the income of the trust. This circularity is also addressed by the amendment to paragraph 108(1)(a) of the Act. Third, the subsection is amended to make it clear that it applies to amounts that are payable to affected beneficiaries. The amendments to this subsection apply after November 12, 1981 where the trust is an inter vivos trust and for taxation years commencing after November 12, 1981 where the trust is a testamentary trust.

Subclause 46(5)

ITA 104(13)(b)

Paragraph 104(13)(b) provides that trust income payable to a beneficiary generally is taxed in the hands of the beneficiary. However, this conflicts with the objective of the rules relating to employee benefit plans which is to tax the employee only when amounts are paid to him and deductible to the employer. Accordingly, paragraph 104(13)(b) is amended to exclude amounts payable by a trust governed by an employee benefit plan. As a result such benefits will be taxed under paragraph 6(1)(g) only when paid. This amendment is applicable to the 1980 and subsequent taxation years when the employee benefit plan rules were first introduced.

Subclause 46(6)

ITA 104(21)(a)(ii)

Subsection 104(21) of the Act enables a trust to designate a portion of its capital gain to be a beneficiary's capital gain. The aggregate amount designated in a particular taxation year cannot exceed the trust's taxable capital gains net of its allowable capital losses for the year and any amount deductible under paragraph 111(1)(b) in respect of a net capital loss carryover.

Under section 111 as amended, a taxpayer is no longer required to claim a net capital loss carryover in the earliest year in which it may be deducted but instead may preserve the loss to be carried forward to later years in the carryover period. The amendment to subparagraph 104(21)(a)(ii) is strictly consequential on this greater flexibility with respect to the application of loss carryovers. It changes the existing reference to amounts "deductible" under paragraph 111(1)(b) to a reference to amounts "deducted" under that paragraph.

This amendment is applicable to the 1983 and subsequent taxation years and in respect of net capital loss carryovers of losses determined in 1983 and subsequent taxation years.

Subclauses 46(7) and (8)

ITA
104(25) and (25.1)

The amendments to subsections 104(25) and (25.1) of the Act are consequential on the amendments to subsection 104(8) of the Act. These amendments apply to taxation years ending after November 12, 1981.

Subclauses 46(9) to (14)

These set out the effective dates of the amendments to section 104 of the Act.

Determination of Cost of Property
ITA
107(3)

Clause 47

Subsection 107(3) of the Act provides a special rule to determine the cost of property, other than non-depreciable capital property, distributed by a trust to a beneficiary in satisfaction of the beneficiary's capital interest in the trust. The amendment to this subsection, effective October 1, 1983, excludes a security held under an indexed security investment plan from this special rule.

Accumulating Income

Clause 48

ITA
108(1)(a)

Paragraph 108(1)(a) of the Act defines the term "accumulating income" of a trust as its income before making any deduction as a result of a preferred beneficiary election and after excluding any taxable capital gains or other income of a spousal trust which arose from a deemed disposition of property under subsection 104(4), (5) or 107(4). This paragraph is amended in two respects. First, it is amended to exclude from accumulating income any taxable capital gain for a year from an indexed security investment plan which arose by virtue of the application of new subsection 104(5.1). Second, it is amended by adding the reference to subsection 104(8) to provide for an ordering in the application of subsections 104(6), (8) and (12).

This amendment applies after November 12, 1981.

Personal Exemptions

Clause 49

Subclause 49(1)

ITA
109(1)

Subsection 109(1) of the Act provides what are generally referred to as personal exemptions. These deductions, in respect of both a taxpayer and his dependants, are currently characterized as deductions from income in computing taxable income. The preamble to subsection 109(1) is amended to permit the personal exemptions to be deducted not only from an individual's income but also from any forward-averaged amounts that he has elected to bring back into taxable income under section 110.4. This amendment is applicable to the 1983 and subsequent taxation years.

Subclauses 49(2) to (4)

ITA
109(1)(d)(iv),
(e)(iv) and (f)(iii)

Subparagraphs 109(1)(d)(iv), (e)(iv) and (f)(iii) of the Act are amended to limit the maximum exemption for a dependant under 18 years of age to $710 for the 1984 and subsequent taxation years. This maximum exemption is reduced by one-half of the dependant's income for the year in excess of $2,350. An amendment to section 117.1 is designed to ensure that the $2,350 will be adjusted annually so that the deduction in respect of a dependant under 18 years of age will effectively cease when his income exceeds the level of the personal exemption available to unmarried individuals.

Subclauses 49(5) and (6)

These set out the effective dates for the amendments to section 109 of the Act.

Other Deductions Permitted

Clause 50

Subclause 50(1)

ITA 110(1)

Subsection 110(1) of the Act permits a taxpayer in computing his taxable income to deduct certain amounts in respect of expenditures such as charitable donations, gifts to Her Majesty and medical expenses. The preamble to subsection 110(1) is amended to permit these amounts to be deducted not only from a taxpayer's income but also from any forward-averaged amounts that he has elected to bring back into taxable income under section 110.4. This amendment is applicable to the 1983 and subsequent taxation years.

Subclause 50(2)

ITA 110(1)(d)

Paragraph 110(1)(d) of the Act is repealed. This means that, for 1984 and subsequent taxation years, the optional $100 standard deduction claimable in lieu of the amount of actual charitable donations and the deductible portion of medical expenses is no longer available.

Subclause 50(3)

ITA 110(1)(f)(iii)

The amendment to subparagraph 110(1)(f)(iii) of the Act corrects an error made in the French version of that subparagraph which was enacted on March 30, 1983.

Subclause 50(4)

ITA 110(2)

Subsection 110(2) of the Act permits an individual who is a member of a religious order and has taken a vow of perpetual poverty to deduct certain amounts paid by him to the order in computing his taxable income for a taxation year. The amendment permits these payments to be deducted not only from a taxpayer's income but also from any forward-averaged amounts that he has elected to bring back into taxable income under section 110.4. This amendment is applicable to the 1983 and subsequent taxation years.

Subclause 50(5)

ITA 110(7)

Subsection 110(6.1) was added to the Act, applicable to the 1982 and subsequent taxation years, to enable a taxpayer to deduct from his income the amount of certain medical expenses incurred by his employer where an amount in respect of such expenses has been included in computing his income. Subsection 110(7) is a general rule that prevents a taxpayer from deducting from income any medical expense in respect of which he has been reimbursed. Subsection 110(7) is amended, effective for the 1982 and subsequent taxation years, to ensure that it does not limit the deduction of expenses provided for by subsection 110(6.1).

Subclauses 50(6) to (8)

These set out the effective dates for the amendments to section 110 of the Act.

Deductions in Computing Taxable Income
ITA
110.1, 110.2
and 110.3

Clauses 51, 52 and 53

Subsection 110.1(1) of the Act provides what is generally referred to as the $1,000 investment income deduction, and subsections 110.2(1) and (2) provide what is generally referred to as the $1,000 pension income exclusion. Section 110.3 permits an individual to deduct, in computing taxable income for a taxation year, certain unused tax deductions of his or her spouse for that year. The provisions are being amended to permit such amounts to be deducted not only from a taxpayer's income but also from any forward-averaged amounts that he has elected to bring back into taxable income under section 110.4. These amendments are effective for the 1983 and subsequent taxation years.

Two other amendments are being made by these clauses. New paragraphs 110.1(5)(c) and (d) provide that dividends received on shares held in an indexed security investment plan do not qualify for the $1,000 investment income deduction. The amendment to paragraph 110.3(b) is also consequential on the forward averaging provisions. Under section 110.3 an individual can transfer such portion of the deductions under sections 110.1 and 110.2 as are not required to eliminate his taxable income. However, under the new forward system an amount may be added in computing taxable income. The amendment to paragraph 110.3(b) provides that the amount transferable to a spouse is to be computed by reference to the aggregate of the spouse's income and the amount, if any, added under subsection 110.4(2) in computing taxable income.

Forward Averaging

Clause 54

Subclause 54 (1)

ITA 110.4(2)

Subsection 110.4(2) of the Act permits an individual to bring into his taxable income for a taxation year throughout which he is resident in Canada all or part of his accumulated averaging amount at the end of the preceding year. His accumulated averaging amount at the end of the preceding year is equal to the indexed total of all amounts deducted in computing his taxable income in preceding years under forward averaging elections minus any amounts which he previously elected to bring back into taxable income under subsection 110.4(2).

Technically, under the existing law, losses cannot offset accumulated averaging amounts brought into taxable income. The amendment allows an offset for non-capital and farm losses. It provides that the amount which would otherwise be required to be included in computing an individual's taxable income for a taxation year under subsection 110.4(2) is reduced by the individual's non-capital loss and farm loss for that year. Any portion of a non-capital loss or farm loss applied under subsection 110.4(2) to offset the increase in taxable income will not be available to be carried over to other taxation years. This change is applicable to the 1983 and subsequent taxation years.

Subclause 54 (2)

ITA 110.4(4)

Under the forward averaging rules, elections to forward average and to bring back into taxable income amounts previously averaged can be made only where the individual was resident in Canada throughout the year. Subsection 110.4(4) of the Act treats a taxpayer, who died in the year and was resident in Canada throughout the portion of the year before the time of his death, as having been resident in Canada throughout that year. This provision enables forward averaging elections to be made in the year of death. The amendment to subsection 110.4(4) of the Act removes the reference to subsection 120.1(1) and is strictly consequential on the amendment to section 120.1 of the Act which removes the requirement that to obtain a forward averaging credit the deceased individual must have been resident in Canada throughout that portion of the year preceding his death. A reference in subsection 110.4(4) of the Act to section 120.1 of the Act is therefore no longer relevant. This amendment applies to the 1982 and subsequent taxation years.

Subclause 54 (3)

ITA 110.4(6)

Subsection 110.4(6) of the Act provides that, where an individual elects to forward average part of his income for a taxation year, he must pay all the assessed tax, interest and penalties within 30 days from the date of his initial assessment for the year. On the other hand, subsection 159(5) of the Act authorizes the legal representatives of a deceased taxpayer to defer the payment of tax under certain circumstances. This amendment is intended to ensure that a deceased taxpayer can benefit from both the forward averaging provisions and the deferral of tax available under subsection 159(5). This change applies to the 1983 and subsequent taxation years.

Subclause 54(4)

ITA
110.4(8)(a)(i)

Paragraph 110.4(8)(a) of the Act defines "accumulated averaging amount" as the net indexed value of income that has previously been forward averaged. Under clause 110.4(8)(a)(i)(C) an individual's accumulated averaging amount at the end of a taxation year is reduced by any amount which he has elected to add in computing his taxable income for the year under subsection 110.4(2). The amendment to the definition is strictly consequential on the change to subsection 110.4(2) which allows an offset of certain losses against forward averaging amounts. Thus, clause 110.4(8)(a)(i)(C), as amended, provides a deduction from the accumulated averaging amount of amounts specified in elections under subsection 110.4(2) instead of a deduction of amounts required to be included in computing taxable income.

Subclause 54(5)

ITA
110.4(8)(a)(ii)

Under the forward averaging system, the annual indexing of the accumulated averaging amount is provided for within the definition of that expression in paragraph 110.4(8)(a) of the Act. This amendment ensures that the indexing of the accumulated averaging amount at the end of a calendar year is computed by reference to the increase in the Consumer Price Index for the 12 month period ending on September 30 of that calendar year. Under the existing provision, reference is made to the 12 month period ending on September 30 of the preceding year. The amendment also provides that the accumulated averaging amount of an individual is not indexed at the end of the year in which he dies. These changes apply to the 1982 and subsequent taxation years.

Subclauses 54(6) to (8)

These set out the effective dates for the amendments to section 110.4 of the Act relating to forward averaging.

Loss carryovers

Clause 55

Subclause 55(1)

ITA
111(1)(a), (b) and (c)

Under subsection 111(1) of the Act a taxpayer may carry over losses of a taxation year to be deducted in computing taxable income of other taxation years. Under the existing provisions, non-capital losses and restricted farm losses may be carried back one year and forward for five years. Non-capital losses are deductible against any type of income but restricted farm losses may be claimed only against farming income. In addition, net capital losses may be carried back one year and forward indefinitely and are deductible only from capital gains except that, where the taxpayer is an individual, $2,000 per year is deductible from other income. Loss carryovers are deductible in the following order: restricted farm losses, non-capital losses and net capital losses.

The amendment to paragraph 111(1)(a) provides that non-capital losses for the 1983 and subsequent taxation years may be carried back three years and forward seven years. The amendment to paragraph 111(1)(b) provides that net capital losses are available for a two-year carryback from the 1984 taxation year and a three-year carryback subsequently. The amendment to paragraph 111(1)(c) provides that restricted farm losses incurred in the 1983 and later taxation years may be carried back three years and forward ten years. A "farm loss", which is a taxpayer's net loss from farming and fishing businesses as defined under new paragraph 111(8)(b.1), may be carried back three years and forward ten years effective from the 1983 taxation year. However, a thee year carryback for 1983 non-capital losses, farm losses and restricted farm losses is only available where the taxpayer is an individual or a corporation eligible for the small business deduction. For other taxpayers, 1983 losses may be carried back only two years. In addition, the ordering of deductions under section 111 is removed so that taxpayers may choose which type or types of loss to deduct in computing taxable income, subject to the restrictions applicable to the deduction of net capital losses and restricted farm losses.

Subclause 55(2)

ITA
111(2)

Subsection 111(2) of the Act provides that, in computing the taxable income of a taxpayer for the taxation year in which he died and the immediately preceding taxation year, his net capital loss carryover is deductible from all sources of income in those years. The amendment to subsection 111(2) is strictly consequential on the changes to paragraph 111(1)(b). The changes are applicable to deaths occurring after 1983.

ITA
111(3)

Paragraph 111(3)(a) of the Act provides that a loss carryover must be claimed first in the earliest taxation year in which it may be deducted. This provision is amended to provide for the deduction of "farm losses" as defined under new paragraph 111(8)(b.1) and to permit a taxpayer to choose not to claim all or part of a loss carryover in computing taxable income for a taxation year but rather to carry such losses forward to be deducted in later years in the carryover period. Paragraph 111(3)(b) provides that losses of each type—non-capital, net capital, and so on—must be utilized in the order in which they were incurred. Thus, for example, 1983 net capital losses must be applied before 1984 net capital losses. This rule is retained but expanded to include a reference to farm losses.

These amendments are applicable to the deduction of losses determined for the 1983 and subsequent taxation years and to the carryforward of losses to the 1983 and subsequent taxation years.

ITA
111(4)

Subsection 111(4) of the Act provides that where control of a corporation is acquired, the corporation's net capital losses for taxation years preceding the acquisition of control may not be carried forward. The amendment to subsection 111(4) adds a further rule which provides that a corporation's net capital loss for a taxation year following acquisition of control of the corporation may not be carried back to taxation years commencing before the acquisition. This amendment applies, subject to certain transitional provisions, to acquisitions of control occurring in the 1982 and subsequent taxation years.

The transitional rule provides that where control is acquired before April 20, 1983, or before April 20, 1984 and pursuant to written arrangements before April 20, 1983, net capital losses may continue to be carried back for one taxation year following the change of control.

ITA
111(5)

Subsection 111(5) of the Act now provides that, where control of a corporation has been acquired, its non-capital losses incurred in carrying on a business in a taxation year ending before the acquisition of control are deductible by it in later years only if certain conditions are met. The amendment to subsection 111(5) provides that the same conditions must be met for the carryforward of farm losses following a change of control. This amendment is applicable to acquisitions of control occurring in the 1984 and subsequent taxation years.

In addition, similar limitations are introduced on the carryback of both non-capital losses and farm losses, so that such losses for a taxation year commencing after the date of the acquisition of control are deductible in a taxation year commencing before that date only where the business in which the loss was sustained is carried on throughout the loss year and in the year in which the loss is to be claimed, and then only to the extent of the corporation's income from the loss business or a similar business. This amendment is applicable, subject to certain transitional provisions, to acquisitions of control occurring in the 1980 and subsequent taxation years. The transitional rules permit a one year carryback of losses following a change of control occurring before April 20, 1983 or before April 20, 1984 in the case of an acquisition of control pursuant to an agreement evidenced in writing before April 20, 1983.

Subclauses 55(3) and (4)

ITA
111(5.1)(b) and
(5.2)(b)

Subsections 111(5.1) and (5.2) of the Act extend the loss carryforward rules to encompass certain unrealized losses. Subsection 111(5.1) provides that, where control of a corporation has been acquired in a taxation year, the excess of the undepreciated capital cost of all its depreciable property of a prescribed class over its fair market value is treated as having been claimed by the corporation as capital cost allowance in previous taxation years. This amount is treated as a non-capital loss of the corporation for the taxation year immediately preceding the year in which control was acquired. Subsection 111(5.2) provides analogous treatment in respect of a corporation's eligible capital property.

The amendments to these provisions are strictly consequential on the introduction of the farm loss carryover in paragraph 111(1)(d) which provides an extended period over which losses incurred in farming and fishing businesses may be claimed. As a result of these amendments, an amount deemed to have been claimed as capital cost allowance or as an allowance in respect of cumulative eligible capital under subsection 111(5.1) or (5.2) in respect of a farming or fishing business will be treated as a farm loss of the corporation for its taxation year preceding the year of acquisition of control.

These amendments apply to acquisitions of control occurring in the 1983 and subsequent taxation years.

Subclause 55(5)

ITA 111(8)

Paragraph 111(8)(b) of the Act defines the "non-capital loss" of a taxpayer for a taxation year. In general terms, a non-capital loss is the excess of the taxpayer's losses for the year from employment, business and property, his allowable business investment loss for the year and amounts deductible in computing taxable income for the year in respect of intercorporate dividends over the amount by which his income from all sources exceeds the deductions he is permitted under sections 60 to 66.4 of the Act.

Section 56 of the Act requires certain categories of non-taxable income, such as workmen's compensation and social assistance payments, to be included in computing the recipient's income, but only for the purpose of determining his status as a dependant. Non-taxation is achieved by allowing a corresponding deduction under paragraph 110(1)(f) for these amounts in calculating the recipient's taxable income. Because section 56 income is netted out in the determination of the recipient's non-capital loss, an unintended effect is that the deductions under paragraph 110(1)(f) effectively reduce or eliminate his non-capital loss for the year. To correct this problem, the amendment to subparagraph 111(8)(b)(i) provides for the addition to a taxpayer's non-capital loss of amounts deductible by him under paragraph 110(1)(f). This correction is retroactive to the 1982 and subsequent taxation years when paragraph 110(1)(f) was made effective.

A further amendment to subparagraph 111(8)(b)(i), effective October 1, 1983, includes the excess of any allowable capital losses for the year from indexed security investment plans over any taxable capital gains for the year from such plans in the calculation of a taxpayer's non-capital loss for a taxation year.

Under the amendment to subsection 110.4(2) of the Act, non-capital losses are applied to reduce any amounts brought into taxable income under the forward averaging provisions. New subparagraph 111(8)(b)(iii) provides that the portion of a non-capital loss which has been applied under subsection 110.4(2) is to be deducted in determining the amount of non-capital loss available to be carried over to other taxation years.

New paragraph 111(8)(b.1) of the Act defines "farm loss" for purposes of the extended farm loss carryover under paragraph 111(1)(d). A farm loss of a taxpayer for a taxation year is the amount which would otherwise be included in his non-capital loss for the year in respect of his net loss from farming and fishing businesses. In order to prevent a double deduction, the amount of a taxpayer's farm loss is deducted in computing his non-capital loss under subparagraph 111(8)(b)(iv). In addition, under subparagraph 111(8)(b.1)(iii) the amount of a taxpayer's farm loss is reduced by any portion thereof applied under subsection 110.4(2) of the Act against forward averaged amounts brought into taxable income.

Sections 2 and 115 of the Act provide that non-residents are subject to Canadian income tax only on income from sources in Canada. Accordingly, paragraph 111(8)(c) of the Act provides that only income and losses from Canadian sources will be included in determining a taxpayer's loss carryover incurred while he was not a resident of Canada. To clarify the application of this limitation, the wording of paragraph 111(8)(c) has been modified with respect to the computation of taxable income for the 1983 and subsequent taxation years and with respect to the determination of losses for those years.

Subclauses 55(6) to (13)

These set out the effective dates for the amendments to section 111 of the Act relating to loss carryovers.

Ordering

ITA
111.1

Clause 56

Section 111.1 of the Act sets out the order in which the various deductions in computing taxable income are to be applied. The amendment to this section provides that the first adjustment in computing taxable income is the addition of accumulated forward averaged income under subsection 110.4(2). This ensures that all other deductions in the determination of taxable income may be claimed against these amounts. The amendment also provides that the deductions in calculating taxable income are to be claimed in the following order:

- personal exemptions under section 109;
- the $1,000 investment income deduction under section 110.1;
- the $1,000 pension income deduction under section 110.2;
- charitable contributions, medical expenses and other deductions provided under section 110;
- unused deductions transferred from a spouse under section 110.3;
- losses under section 111; and
- amounts elected in respect of forward averaging under subsection 110.4(1).

The new provision applies to the 1983 and subsequent taxation years.

Loss on Shares

Clause 57

ITA
112(4) and (4.1)

Subsections 112(4) and (4.1) of the Act set out special rules which require dividends to offset certain losses arising on a disposition of shares. The amendments to these subsections provide that, effective October 1, 1983, losses on shares owned under an indexed security investment plan are not subject to these rules.

Individual Resident in Canada During Part of the Year
ITA
114

Clause 58

Section 114 of the Act provides rules for computing the taxable income of an individual who was resident in Canada during part of a taxation year. This section is amended to clarify that section 114 applies to a part-year resident notwithstanding the general definition of taxable income in subsection 2(2) of the Act. A further amendment, adding new subparagraph 114(a)(iii), provides that any amount deemed by subsection 48(1.1) to be a capital gain or capital loss from an indexed security investment plan for a taxation year in which an individual ceases to reside in Canada will be considered to relate to the period when the individual was resident in Canada. Accordingly, any such gain or loss will be reflected in the calculation of his taxable income for that period. These amendments are applicable to the 1983 and subsequent taxation years.

Taxable Income of Non-residents
ITA
115(1)(f)

Clause 59

Subsection 115(1) of the Act determines the amount of the taxable income earned in Canada on which a non-resident is subject to taxation under Part I of the Act. In computing this amount, paragraph 115(1)(f) permits deductions provided in Division C (sections 109 to 113 of the Act) where all or substantially all of the non-resident's income for the year is from employment in Canada or carrying on business in Canada or is a scholarship, bursary or research grant received by a former Canadian resident. The amendment to paragraph 115(1)(f), applicable to the 1983 and subsequent taxation years, extends the application of the paragraph to permit Division C deductions where all or substantially all of the non-resident's income for the year is included in computing his taxable income earned in Canada for the year.

Special Table

ITA
117(6)

Clause 60

To facilitate the computation of the tax payable by most individuals, a table is prepared and included in the annual personal tax return package showing the amount of tax payable for given levels of taxable income. Subsection 117(6) of the Act provides the authority for this tax table. The amendments to subsection 117(6), effective for the 1982 and subsequent taxation years, clarify that the amount determined in the tax table represents tax payable exclusive of the special deduction for the unused portion of the $200 federal tax reduction of the taxpayer's spouse and of any tax adjustment made under the forward averaging provisions and without regard to various tax credits such as the investment tax credit and the new share-purchase and scientific research tax credits.

Annual Adjustment

Clause 61

ITA
117.1

Section 117.1 of the Act provides for the annual indexing of individual income tax brackets, personal exemptions and the child tax credit.

Paragraph 117.1(1)(b) of the Act is repealed and subsection 117.1(3) of the Act is amended to eliminate any further indexing of the current $710 personal exemption for a dependant under 18 years of age. Subsections 117.1(1.1) and (6) of the Act are also amended to provide a new $343 base for indexing the child tax credit after 1983 and to deny any further indexing of the threshold amount of income beyond which the credit is reduced. In addition, as a consequence of the repeal of the $100 optional standard deduction, various adjustments are made to subsections 117.1(2) to (5) and a consequential amendment changes a cross-reference to subsection 117.1(1) in subsection 117.1(8). These amendments are effective for the 1984 and subsequent taxation years.

Block averaging

Clause 62

Section 119 of the Act permits what is generally referred to as five-year "block averaging" for determining taxes payable by farmers and fishermen.

Subclause 62(1)

ITA
119(1)(a)

Block averaging generally permits a farmer or fisherman to elect to calculate his tax on the basis of his average taxable income over a five year period. Under existing paragraph 119(1)(a) of the Act no amount is deductible in making the average taxable income calculation in respect of a loss for the year following the year of averaging. The amended section 111 of the Act provides for a three year carryback of losses in computing taxable income. The amendment to paragraph 119(1)(a) is strictly consequential on the extension of the carryback period. It excludes from the calculation losses carried back from the three years following the year of averaging. To give effect to losses carried back from 1983, the change is effective for the 1980 and subsequent taxation years.

Subclauses 62(2) to (5)

ITA
119(1)(d) to (h)
119(2)(b), (c) and (d)
119(9) and (10)

Section 119 of the Act deals with block averaging for farmers and fishermen. Block averaging provides for the averaging of income for such taxpayers over a five year period where they so elect. The section is amended as a consequence of the new rules governing the investment tax credit. The amendments provide that in calculating the average tax of a taxpayer for the averaging period only the amount of credit actually claimed for the preceding years in that period is to be taken into account. The amendment provides for an adjustment to the investment tax credit pool where the total credits actually claimed for those years exceed the aggregate of the average taxes for those years. Under the amendments to this section, any such excess is added back to the investment tax credit pool of the taxpayer and is eligible for a seven year carryforward from the year in which it is added back. These amendments are applicable to the 1983 and subsequent taxation years.

ITA
119(8)

A separate amendment in subclause 62(5) deals with subsection 119(8) of the Act. Subsection 119(8) provides that loss carryovers deducted in the block-averaging calculation under subsection 119(1) are not available to be carried over and deducted in other taxation years. Under the amended section 111 a taxpayer has the option of deducting a loss carryover in any taxation year in the carryover period to the extent that it has not previously been deducted. Consequently, subsection 119(8) of the Act is amended to deem an amount in respect of a loss included in the block-averaging calculation under subparagraph 119(1)(b)(ii) of the Act to have been "deducted" rather than "deductible" for the purposes of computing taxable income for taxation years following the year of averaging. This applies to the 1983 and subsequent taxation years.

Subclauses 62(6) and (7)

These set out the effective dates for the amendments to section 119 of the Act.

Tax Payable by Individuals

Clause 63

Subclause 63 (1)

ITA 120(3.1)

In computing tax payable for the 1983 taxation year, an individual is permitted a special federal tax credit of up to $200. The amendments to subsection 120(3.1) of the Act provide that starting with the 1984 taxation year, this special federal tax credit will be reduced by 10 per cent of the amount by which the individual's basic federal tax exceeds $6,000. The amendments also limit the maximum amount of the credit to $100 for 1985 and $50 thereafter.

Subclause 63 (2)

ITA 120(4)(c)

Paragraph 120(4)(c) of the Act defines the expression "tax otherwise payable under this Part" and is relevant in determining the amount of additional tax that is payable by an individual in respect of income that was not earned in a province. Effectively, subsection 120(1) provides for federal taxes on income that is not attributed to a province. The expression is also relevant in determining the special Quebec abatement and the $200 federal tax reduction. The amendment to paragraph 120(4)(c) excludes from the definition any deduction from tax for the share-purchase tax credit under section 127.2 of the Act. This amendment is applicable to the 1982 and subsequent taxation years.

Subclauses 63 (3) and (4)

These set out the effective dates for the amendments to section 120 of the Act.

Forward Averaging

Clause 64

ITA
120.1(1) and (2)

Section 120.1 of the Act provides for a tax adjustment where a forward averaging election is made. Subsection 120.1(1) allows a deduction from tax where an amount previously forward averaged is brought back into taxable income whereas subsection 120.1(2) provides for an addition to tax for any year in which an individual forward averages an amount.

To prevent any duplication of these tax adjustments, the amendments to subsections 120.1(1) and (2) ensure that no addition or deduction under the forward averaging provisions is made in computing the tax payable with respect to a return of income that is not the regular annual return of the taxpayer for the year. They also ensure that a deceased individual will obtain a tax credit with respect to his accumulated averaging amount provided he was resident in Canada at the time of his death.

Subsection 120.1(1) provides that where an individual elects to bring an amount back into income under the forward averaging provisions he may claim a tax credit equal to the product obtained when the top federal marginal rate for the year of inclusion is multiplied by the amount included in taxable income. The amendment to subsection 110.4(2) of the Act provides for a deduction of any non-capital loss and farm loss for the year from a forward averaged amount otherwise included in taxable income. To ensure a full tax credit in these cases, subsection 120.1(1) is amended to allow an individual a tax credit determined by reference to the full amount specified in his election under subsection 110.4(2) rather than the lower amount included in his taxable income. This amendment is applicable to the 1982 and subsequent taxation years.

ITA
120.1(2)

Paragraph 120.1(2)(b) of the Act sets out the rules that apply when an individual dies at a time when he has an accumulated averaging amount which has not been brought back into taxable income. This amount will be taxed in the year of death as if one third thereof were added to the individual's taxable income in each of the three years preceding the year in which he died. A tax credit against this tax is provided under subsection 120.1(1) equal to the product obtained when his accumulated averaging amount is multiplied by the top federal marginal tax rate. This amendment ensures that the tax payable pursuant to paragraph 120.1(2)(b) is based on the amounts which would otherwise have been included in taxable income in the three years preceding death minus any of the individual's non-capital losses and farm losses for those years.

Other amendments to subsection 120.1(2) of the Act simplify the calculation of the tax payable on the accumulated averaging amount upon death. These amendments ensure that, in recomputing the tax payable for the three years preceding death, it will not be necessary to take into account the various additions required or deductions allowed in computing the tax payable for those years nor will it be necessary to take into account the tax adjustments under the forward averaging provisions.

The amendments to section 120.1 of the Act are effective for the 1982 and subsequent taxation years.

Tax Rate of Mutual Fund Trust
ITA
122(3)(a)(i)

Clause 65

Paragraph 122(3)(a) of the Act establishes the tax rate for a mutual fund trust on its net taxable capital gains. The amendments to subsection 111(3) of the Act provide that a taxpayer is no longer required to claim a net capital loss carryover under paragraph 111(1)(b) in the earliest year in which it is deductible. A taxpayer may now defer the deduction of all or any part of a net capital loss carryover from one year to any subsequent taxation year. The amendment to subparagraph 122(3)(a)(i) is consequential on this change. It provides that the net taxable capital gains of a mutual fund trust are to be determined by reference to net capital losses "deducted" rather than "deductible" under paragraph 111(1)(b). This is applicable for losses determined for the 1983 and subsequent taxation years.

Child Tax Credit

Clause 66

Subclause 66(1)

ITA 122.2(1)

Subsection 122.2(1) of the Act provides for an indexed child tax credit in respect of children under 18 years of age at the end of the year. The amendments set the 1983 tax credit at $343 for each eligible child and provide that this amount will be indexed in subsequent years. In addition, subsection 122.2(1) of the Act is amended to ensure that in computing the threshold amount of family income for the purposes of this credit, the income of an individual who has an eligible child and that of any supporting person of an eligible child of that individual is to be taken into account. Another amendment fixes the threshold amount of family income beyond which the credit is reduced at $26,330 for the 1983 taxation year. This threshold amount is not indexed for future years.

Subclause 66(2)

ITA 122.2(2)(b)

The amendment to subsection 122.2(2) of the Act deals with the income threshold rules relating to the child tax credit. Under the existing rules, where the credit is claimed by a married person living with a spouse at the end of the year, the incomes of both spouses are aggregated. The amendment to paragraph 122.2(2)(b), in conjunction with the amendments to subsection 122.2(1), provides that if both parents of the eligible child are living together at the end of the year, the incomes of the parents are aggregated. Finally, the income of any person claiming a personal exemption in respect of the child must be aggregated with that of the person claiming the credit. This change is effective for the 1983 and subsequent taxation years.

Subclause 66(3)

This sets out the effective dates for the amendments to section 122.2 of the Act relating to the child tax credit.

Overseas Employment Tax Credit
ITA
122.3

Clause 67

Effective for the 1984 and subsequent taxation years, the overseas employment tax credit under new section 122.3 replaces the overseas employment deduction that was previously provided under subsections 8(10) and (11) of the Act. This new tax credit is available to individuals resident in Canada working abroad for six consecutive months or longer for a specified employer in connection with a resource, construction, installation, agricultural or engineering project. Under new section 122.3, the amount of the credit is generally equal to that proportion of the employee's tax otherwise payable for the year that the lesser of $80,000 and 80 per cent of his net overseas income taxable in Canada is of his total income for the year. The effect of this formula is to provide a tax reduction in respect of a maximum of $100,000 of overseas employment income. For example, if a Canadian employee is overseas throughout a year and earns $90,000 of qualifying income, his overseas employment tax credit would equal the amount of his tax otherwise payable on $72,000 (that is, 80 per cent of $90,000). If the employee had earned $120,000 of qualifying income, his credit would be the amount of his tax otherwise payable on $80,000 since in this case 80 per cent of $120,000 (that is, $96,000) exceeds the $80,000 limit.

The $80,000 represents an annual limitation and is therefore prorated where the employee is abroad for less than a full year. The circumstances under which an employee qualifies for the new credit are similar to those under the existing provisions relating to the overseas employment deduction. However, income from employment under a prescribed international development assistance program will not qualify for the overseas employment tax credit where employment abroad commences after 1983.

Corporation Surtax

ITA
123.4(a)
123.5(a)

Clauses 68 and 69

Section 123.4 of the Act imposes a 5 per cent corporate surtax for the 1982 calendar year and section 123.5 imposes a 2½ per cent corporate surtax for 1983. Paragraphs 123.4(a) and 123.5(a) are amended to provide that the amount of the surtax is calculated by reference to a corporation's federal tax otherwise payable before the deduction of any share-purchase tax credit or scientific research tax credit to which it is entitled.

Small Business Deduction

Clause 70

Subclause 70(1)

ITA 125(2) to (5)

Subsection 125(2) of the Act defines the "business limit" and the "total business limit" of a corporation for the purpose of calculating the corporation's small business deduction. Under the rules in subsections 125(2) to (5) the limits are apportioned among Canadian-controlled private corporations that are associated. Associated corporations may allocate the business limit and total business limit among themselves by filing a prescribed agreement under subsection 125(3) of the Act or, if such an agreement is not filed, the Minister of National Revenue will make the allocation under subsection 125(4) of the Act. Subsection 125(5) addresses certain limited cases where a Canadian-controlled private corporation that has two taxation years ending in the same calendar year is associated in each of those taxation years with another Canadian-controlled private corporation that has only one taxation year ending in the calendar year. The subsection prevents the corporation from obtaining a small business deduction in its second taxation year by deeming its business limit for that year to be nil.

Subsection 125(2) to (5) of the Act are amended, effective for the 1983 and subsequent taxation years, to expand the group of associated corporations that must share the small business deduction so as to include, in addition to Canadian-controlled private corporations, any corporation that ceased to be a Canadian-controlled private corporation after August 15, 1983. This expanded group, referred to as an "associated group", is defined in new paragraph 125(6)(m) of the Act. These amendments ensure that associated Canadian-controlled private corporations cannot increase their small business deductions by having one or more members of the group cease to maintain Canadian-controlled private corporation status. Without these amendments, increased small business deductions would arise as a result of the ability to ignore the cumulative deduction account of the corporation whose status after August 15, 1983 had changed, for example, by obtaining articles of continuance in a foreign jurisdiction or by becoming a public corporation.

Subclauses 70(2) to (4)

Paragraph 125(6)(b) of the Act provides rules for calculating the cumulative deduction account of a corporation to determine its eligibility for the small business deduction. A corporation or an associated group of corporations may no longer claim the small business deduction where its cumulative deduction account is $1,000,000 or more at the end of the preceding taxation year.

ITA 125(6)(b)(i)

The amendment to subparagraph 125(b)(i) is consequential on the revision of subsection 125(8.1) and ensures that additions to the cumulative deduction account under revised subsection 125(8.1), which are to be made on an annual basis as required, will not continue to affect a corporation's cumulative deduction account where the reason for the addition no longer exists.

ITA 125(6)(b)(iii.2)

Existing subparagraph 125(6)(b)(iii.2) of the Act provides that the cumulative deduction account of a corporation includes any additions made to this account pursuant to subsections 125(8.1) and (8.4). As such, these additions, once made, become permanent components of a corporation's cumulative deduction account. This amendment deletes the reference to subsection 125(8.1). It is consequential on the amendment which provides that an amount added to the cumulative deduction account for any year under subsection 125(8.1) adjusts the account for that year only and does not give rise to a permanent addition to the account.

ITA
125(6)(b)(iv)

Existing subparagraph 125(6)(b)(iv) of the Act provides that a corporation's cumulative deduction account is reduced in respect of dividends that it pays out of its business income to another corporation with which it is associated. Such dividends, called "qualifying taxable dividends", are defined in subparagraph 125(6)(c)(iii) so as to exclude the portion paid out of investment income. Since both of these provisions exclude the portion of dividends paid out of investment income, an unintended effect is that the adjustment to exclude dividends paid out of investment income is made twice, thereby understating the intended deduction for dividends paid out of business income. The amendment to subparagraph 125(6)(b)(iv) corrects this problem and is effective for the 1982 and subsequent taxation years.

ITA
125(6)(b)(iv.2)

The proposed amendment deleting existing subparagraph 125(6)(b)(iv.2) of the Act is strictly consequential on the repeal of existing subsections 125(8.5) and (8.6).

The introduction of new subparagraph 125(6)(b)(iv.2) is consequential on the introduction of new subsection 125(8.5). This subsection provides for a reduction of a corporation's cumulative deduction account in respect of dividends it has received from an associated corporation whose cumulative deduction account is effectively in a negative balance.

New subparagraph 125(6)(b)(iv.2) ensures that the reduction is reflected in the definition of "cumulative deduction account" and is effective for the 1980 and subsequent taxation years.

Subclause 70(5)

ITA
125(6)(c)

Paragraph 125(6)(c) defines "qualifying taxable dividends paid" for the purpose of calculating a corporation's cumulative deduction account. The amendments to this paragraph limit these dividends, effective for the 1983 and subsequent taxation years, to those paid out of business income by one corporation that is a member of an "associated group", as defined in new paragraph 125(6)(m), to another member of that group. Certain of the amendments to paragraph 125(6)(c) are strictly consequential on the amendments to subsections 125(2) to (5) which provide that the small business deduction must be shared by the members of an associated group. These consequential amendments adopt the appropriate references to "associated group" effective for the 1983 and subsequent taxation years.

"Qualifying taxable dividends paid" exclude dividends on which the recipient corporation is required to pay Part IV tax, since such dividends are considered to be paid by the payer corporation out of its investment income. An amendment extends this exclusion to dividends to which the Part IV tax does not apply as a result of the application of non-capital losses by the recipient corporation to reduce or eliminate its Part IV tax liability. This amendment is applicable to taxation years commencing after March, 1983.

Subclause 70(6)

ITA 125(6)(m)

The amended subsections 125(2) to (5) of the Act require the members of an "associated group" in a taxation year to share the small business deduction by allocating the business limit and total business limit among the members. Revised subsection 125(8.5) also refers to an "associated group" and provides rules for circumstances where there is a negative cumulative deduction account.

An "associated group" in a taxation year is defined in new paragraph 125(6)(m) as a group of associated corporations each member of which is either a Canadian-controlled private corporation or a corporation that was, at any time after August 15, 1983 and before the end of the taxation year, a Canadian-controlled private corporation. This new definition broadens the concept of associated corporations for the purpose of the small business deduction to include corporations that were Canadian-controlled private corporations but that have changed their status after August 15, 1983—for example, by obtaining articles of continuance in a foreign jurisdiction or by becoming a public corporation.

New paragraph 125(6)(m) is applicable for the 1983 and subsequent taxation years and, for the purposes of new subsection 125(8.5), it is applicable in a modified form for the 1980 to 1982 taxation years. In its modified form, an associated group in a taxation year will include only Canadian-controlled private corporations that are associated with each other in the year.

Subclause 70(7)

ITA 125(6.1)

Subsection 125(6.1) of the Act provides rules for the purpose of computing the cumulative deduction account of a corporation where it has paid or received a dividend as part of a "butterfly" reoganization under paragraph 55(3)(b) of the Act or as part of certain share transactions or business transfers to which existing subsection 125(8.1) applies. In these cases, the dividends and related Part IV tax and dividend refunds are to be ignored in computing the cumulative deduction account. The amendments to subsection 125(6.1) are strictly consequential on the amendments to subsections 125(8.1) and (8.4) of the Act.

Existing paragraph 125(6.1)(a) does not apply to dividends between non-arm's length parties on a butterfly reorganization. The amendments extend the application of this paragraph to include such dividends since the amended subsection 125(8.4) will apply to both arm's length and non-arm's length butterfly reorganizations. The amendments also repeal existing paragraph 125(6.1)(b), which is no longer required as a result of the amendments to subsection 125(8.1).

These amendments apply in computing cumulative deduction accounts for the 1982 and subsequent taxation years.

Subclause 70(8)

ITA 125(6.2)(b)

Subsection 125(6.2) of the Act provides rules for computing the cumulative deduction account of a corporation where dividends are paid between associated corporations one of which carries on a non-qualifying business while the other carries on an active business. In such cases, the amount included in the recipient's cumulative deduction account in respect of the dividend is equal to the amount deducted from the payer's account. As a result, the total cumulative deduction account of the group is not affected by such dividends. The amendment to paragraph 125(6.2)(b) changes a cross-reference as a consequence of the amendment to clause 125(6)(b)(iv)(A).

Subclause 70(9)

ITA
125(6.3)

Subsection 125(6.3) of the Act provides rules for computing cumulative deduction accounts with respect to dividends between associated corporations where their taxation years end in different calendar years. The amendment to the subsection ensures that the adjustments to the cumulative deduction accounts of both the payer and recipient corporations are made in the same taxation year. This prevents potential understatements and overstatements of the group's cumulative deduction account at the end of a taxation year. Subsection 125(6.3) has also been expanded to cover the situation where the recipient corporation may have been wound up in order to avoid the application of these rules.

The amendments are applicable in computing cumulative deduction accounts for the 1982 and subsequent taxation years.

Subclause 70(10)

ITA
125(8.1) and (8.2)

Existing subsections 125(8.1) to (8.6) of the Act set out detailed rules designed to ensure that the small business deduction is not increased as a result of certain business transfers or share transactions. These amendments replace those detailed rules with general anti-avoidance provisions.

New subsection 125(8.1) provides that where one of the main reasons for a transaction or event or series of transactions or events is to effect an increase in the amount of the claim for the small business deduction of any corporation, adjustments to the corporation's cumulative deduction account are to be made to eliminate the increased claim.

Where more than one corporation could benefit from such an increased claim, the corporations may agree to eliminate the increase in any manner they choose by adjusting their respective cumulative deduction accounts. Where they fail to do so subsection 125(8.2) empowers the Minister to make such adjustments.

Although new subsection 125(8.1) applies to both arm's length and non-arm's length transactions, it will apply only where one of the main reasons for a transaction is to increase the claim for the small business deduction. Accordingly, the subsection will not apply where the claim has been increased as a result of certain transactions such as a bona fide arm's length takeover of a business or a corporation, even where the takeover is preceded by the payment of a dividend to an associated corporation. Nor is it intended that these provisions apply where shares or a business of a corporation are transferred from a parent to an adult child where the child is actively involved in the management of the business. Revenue Canada, Taxation, has agreed to administer these provisions and rule on proposed transactions in accordance with these policy guidelines.

New subsections 125(8.1) and (8.2) are applicable to transactions or events or a series of transactions or events commencing after April 5, 1983, when these provisions were first published. However, the repeal of existing subsections 125(8.1) and (8.2) as well as that of existing subsections (8.3) to (8.6) is applicable for the 1982 and subsequent taxation years.

ITA 125(8.3)

Subsection 125(8.3) of the Act expands on those circumstances that are considered to be business transfers for the purposes of the rules provided in subsection 125(8.1). The existing provision applies only to non-arm's length transfers. This amendment broadens the scope of subsection 125(8.3) to include arm's length transfers and is consequential on the corresponding change to subsection 125(8.1).

ITA 125(8.4)

Subsection 125(8.4) of the Act provides rules for allocating the cumulative deduction account of a corporation among its corporate shareholders in proportion to the value of the property that each shareholder received as part of an arm's length "butterfly" reorganization commencing after December 1, 1982. This amendment extends the application of the subsection to all butterfly reorganizations, including non-arm's length butterfly reorganizations, commencing after November 12, 1981. A transitional rule, however, ensures that this subsection will not apply to butterfly reorganizations commencing before December 1, 1982 unless the parties agree that it apply. In addition, the subsection will not apply to non-arm's length butterfly reorganizations commencing before April 6, 1983 unless the parties agree that it apply.

ITA 125(8.5)

As amended, subsection 125(8.5) introduces a new rule, applicable with respect to dividends paid by a corporation in its 1980 and subsequent taxation years, to provide relief where the cumulative deduction account goes negative. In cases where the cumulative deduction account of a payer corporation is negative—that is, where it is not large enough to cover the deduction allowed under subparagraph 125(6)(b)(iv) in respect of a qualifying taxable dividend paid by it—subsection 125(8.5) as amended requires each recipient corporation to deduct, in computing its cumulative deduction account for its taxation year in which the dividend was paid, an amount equal to its share of the payer corporation's negative cumulative deduction account based on its proportionate share of the dividend. In the absence of this rule, qualifying taxable dividends paid by a member of a group of associated corporations to another member of the group in these circumstances would impair the group's eligibility for the small business deduction.

With the extension of the loss carryback rules to three years and the resulting retroactive reductions in cumulative deduction account balances, the potential incidence of negative accounts will increase. Subsection 125(8.5) allows loss carrybacks without impairing overall access to the small business deduction by members of an associated group.

Subclause 70(11)

ITA 125(6)(b)(iv)

Under paragraph 125(6)(b) of the Act, dividends paid by a corporation before 1982 out of its business income will generally reduce the payer corporation's cumulative deduction account. An exception is provided for dividends paid to a private corporation which is connected but not associated with it and on which no Part IV tax is paid. After 1981, only dividends paid out of business income to an associated Canadian-controlled private corporation on which no Part IV tax is paid will reduce the payer corporation's cumulative deduction account. Since the cumulative deduction account is determined on the basis of complete taxation years, this change to the definition of "qualifying taxable dividends paid", effective January 1, 1982, necessitates a transitional rule for taxation years that straddle that date.

This amendment provides that any dividends paid by a corporation in its 1982 straddle year will, to the fullest extent possible, be treated as paid out of its business income. The transitional rule also assumes that where the recipient is a private corporation that is connected but not associated with the payer corporation, and the recipient has elected to pay Part IV tax on dividends, the election will be considered to be in respect of 1981 dividends before 1982 dividends. These assumptions ensure that dividends will generally reduce a corporation's cumulative deduction account to the same extent as they would have done had the corporation's taxation year ended on December 31, 1981.

Subclauses 70(12) to (18)

These set out the effective dates for the amendments to section 125 of the Act.

Manufacturing and Processing Tax Credit
ITA
125.1(1)(a)(ii)(D)

Clause 71

Section 125.1 of the Act provides a reduced rate of corporate tax for Canadian manufacturing and processing income. The rate reduction takes the form of a special credit of 6 per cent (5 per cent in the case of business profits eligible for the small business deduction) of such income against the federal corporate tax otherwise payable. The amount on which the 6 per cent credit is based may not exceed the corporation's taxable income that did not qualify for the small business deduction under subsection 125(1) of the Act and that does not represent either business income that was taxed in a foreign jurisdiction or investment income. For this purpose, the corporation's investment income is to be reduced by its net capital loss carryover that is deductible in the year. As a result of the amendment to subsection 111(3), a net capital loss carryover need no longer be claimed in the earliest year in which it is deductible, but it may instead be preserved to be applied in computing taxable income in later years. Accordingly, the determination of a corporation's net investment income under clause 125.1(1)(a)(ii)(D) of the Act is changed to refer to net capital losses "deducted" rather than those "deductible" under paragraph 111(1)(b). This change is applicable to losses determined in the 1983 and subsequent taxation years.

Foreign Tax Credit

Clause 72

Section 126 of the Act permits a taxpayer to claim a foreign tax credit. Subsection 126(1) sets out the rules for claiming the credit in respect of foreign non-business-income tax—that is, the foreign taxes imposed on investment income and other categories of foreign source non-business income. A credit in respect of foreign taxes on business income is provided under subsection 126(2). Neither credit may exceed the Canadian tax otherwise payable in respect of the foreign source income. Canadian tax otherwise payable on foreign source income is determined by reference to the ratio of the foreign source income to total income.

Subclauses 72(1) and (4)

ITA 126(1)(b)(i)(E) and 126(7)(c)

An individual's foreign employment income which qualifies for the overseas employment tax credit under new section 122.3 of the Act is effectively free from Canadian tax. Consequently, new subclause 126(1)(b)(i)(E)(II) provides that such amounts are not to be included in foreign source income for purposes of the foreign tax credit calculation. Similarly, foreign taxes on income eligible for the overseas employment tax credit are excluded from the definition of "non-business income tax" under paragraph 126(7)(c) and are thereby excluded from the foreign tax credit calculation. These provisions apply with the introduction of the overseas employment tax credit in 1984.

Subclauses 72(2) and (3)

ITA 126(1)(b)(ii) and 126(2.1)(a)(ii)

The inclusion of forward-averaged amounts in taxable income under subsection 110.4(2) of the Act will in most circumstances result in an increase of an individual's Canadian tax otherwise payable. This increased tax and the addition to taxable income should be taken into account in determining the foreign tax credit limitation. Under the existing rules only the increased tax is brought into the formula. The amendments to clauses 126(1)(b)(ii)(A) and (2.1)(a)(ii)(A) ensure that the amounts added to taxable income under subsection 110.4(2) are included in total income for the purpose of the foreign tax credit calculation. These changes are effective for the 1983 and subsequent taxation years.

Total income under the present foreign tax credit limitation is reduced by a taxpayer's deductible net capital losses carried over from other taxation years. The amendment to subsection 111(3) of the Act provides that a net capital loss carryover need not be claimed under paragraph 111(1)(b) in the earliest year in which it is deductible, but may instead be preserved to be applied in computing taxable income in later years. Accordingly, these amendments also provide that total income, which is determined under subparagraph 126(1)(b)(ii) for the non-business income foreign tax credit and under subparagraph 126(2.1)(a)(ii) for the business income foreign tax credit, is to be reduced by net capital loss carryovers that are "deducted" rather than those that are "deductible" under paragraph 111(1)(b). This applies for losses determined in the 1983 and subsequent taxation years.

Subclause 72(5)

ITA 126(7)(d)

Paragraph 126(7)(d) of the Act defines Canadian tax otherwise payable for purposes of the formula for determining the foreign tax credit limitation. Subparagraphs (i) to (iii) are amended as a result of the new overseas employment tax credit, share-purchase tax credit and scientific research tax credit. The effect is to ignore these credits in determining the Canadian tax otherwise payable in paragraph 126(7)(d). These changes are applicable to the 1982 and subsequent taxation years.

Subclauses 72(6) to (8)

These set out the effective dates of the amendments to section 126 of the Act relating to the foreign tax credit.

Tax Credits

Clause 73

Subclause 73(1)

ITA
127(4.1)

Subsection 127(4.1) of the Act defines an "amount contributed" for the purposes of the calculation of a taxpayer's tax credit in respect of political contributions. Where a taxpayer makes a contribution to a registered political party or officially nominated candidate, subsection 127(3) allows a tax credit of up to $500 depending upon the amount of contribution. The amendment ensures that a tax credit is not available for contributions in respect of which the taxpayer has received or is entitled to receive any other financial benefit, other than a prescribed benefit, from a government or other public authority. Thus a contribution that qualifies for a grant, subsdidy, deduction from tax (other than the deduction under subsection 127(3)) or provincial credit will not qualify for this credit. This rule applies for contributions made after April 19, 1983.

Investment Tax Credit

Subclause 73(2)

ITA
127(5)

Subsection 127(5) of the Act sets out the limits on the deduction of investment tax credit from federal tax payable. Under the existing provision, where the federal tax for a year exceeds $15,000, only half of the excess may be eliminated by investment tax credits. The amendment to subsection 127(5) allows investment tax credits earned after April 19, 1983 to be fully deducted from federal tax payable, without regard to the limitation on taxes in excess of $15,000. Thus investment tax credits earned on and after April 20, 1983 are fully deductible against any federal tax remaining after the deduction of investment tax credits earned before that date. This change, taken together with the amendments to subsection 127(9), also allows a full offset against federal tax for any years in the carryback period to which the new credits may be applied. However, investment tax credit earned in a year cannot be carried back except to the extent that tax payable in the year is insufficient to permit deduction of the credit. (Note that investment tax credits earned before April 20, 1983 continue to be subject to the 50 per cent limitation.)

Subclause 73(3)

ITA
127(9)(a)

Subsection 127(9) of the Act provides the formula for the computation of the investment tax credit of a taxpayer at the end of a year. Paragraph 127(9)(a) is amended to extend the 7 per cent credit to qualified construction equipment acquired after April 19, 1983. The expression "qualified construction equipment" is defined in paragraph 127(10.1)(f) of the Act.

Subclauses 73(4) to (7)

ITA
127(9)(b), (b.1),
(b.2), (d), (d.2),
(e) and (f)

The amendments to paragraphs 127(9)(b), (b.1), (d), (d.2), (e) and (f) are for the purpose of extending the carryover period for the investment tax credit. Credits earned after April 19, 1983 that cannot be claimed in the year they are earned may be carried back for 3 taxation years (but in no event to a taxation year before 1981) and may be carried forward for 7 taxation years. The extended carryover applies only in respect of investment tax credits earned on or after April 20, 1983. Investment tax credits earned before that date may not be carried back and still continue to qualify for a five year carryforward.

ITA 127(9)(d.3)

Paragraph 127(9)(d.3) has been added to the Act to provide for a special addition to the investment tax credit pool of a farmer or fisherman who has taken advantage of block averaging under section 119. This special addition is described in the notes on the amendments to that section.

ITA 127(9)(g)

Paragraph 127(9)(g) is added to the Act as a consequence of the introduction of the refundable Part VII tax in respect of the new share-purchase tax credit. A corporation is liable under Part VII of the Act for an amount of tax equal to the amount of the special credit that is flowed-out to investors through an issue of shares under the Share-Purchase Tax Credit program. Paragraph 127(9)(g) reduces a corporation's investment tax credit pool by the amount of investment tax credit used by it to offset its liability for the Part VII tax.

ITA 127(10.1)(c)

Paragraph 127(10.1)(c) of the Act defines those scientific research expenditures which qualify for the investment tax credit. This amendment removes from that definition those expenditures which a corporation has renounced under the new scientific research financing mechanism. Thus, those expenditures specified by a corporation under new clause 194(2)(a)(ii)(A) in order to obtain a refund of the new Part VIII tax will not qualify for the investment tax credit. These expenditures also reduce the scientific research expenditures that are deductible as an expense under subsection 37(1) of the Act. This amendment applies to expenditures made after April 19, 1983.

Subclause 73(9)

ITA 127(10.1)(f)

Paragraph 127(10.1)(f) of the Act provides a definition of qualified construction equipment. The 7 per cent investment tax credit was extended to such equipment acquired after April 19, 1983. The type of equipment eligible for the tax credit will be prescribed in the Income Tax Regulations. It must be new equipment acquired for construction in Canada in the course of carrying on a business. Prescribed equipment will include property in class 22 and certain other heavy equipment such as cranes and pile-drivers.

Subclause 73(10)

ITA 127(11.1)(a)

The amendment to paragraph 127(11.1)(a) adds a reference to "qualified construction equipment"for the purpose of establishing the appropriate rate of tax credit applicable thereto. For such equipment acquired after April 19, 1983 the rate is 7 per cent.

Subclauses 73(11) and (12)

ITA 127(11.1)(b) and (c)

Paragraph 127(11.1)(b) of the Act sets out the existing investment tax credit rates of 10 per cent, 20 per cent and 25 per cent earned on qualifying scientific research expenditures. Under new paragraph 127(11.1)(c) of the Act, these rates are being increased to 20 per cent, 30 per cent and 35 per cent for expenditures made in taxation years ending after October 31, 1983. These higher tax credits compensate for the repeal of the special incremental research allowance under section 37.1 of the Act.

The repeal of section 37.1 is generally effective for taxation years ending after October 31, 1983. However, as set out in the commentary on clause 12, there are some transitional cases where section 37.1 will continue to apply in later years. New paragraph 127(11.1)(c) of the Act addresses these cases and ensures that the new higher rates will not apply to scientific research expenditures made by a corporation in any taxation year in which it deducts the special incremental research allowance under section 37.1 of the Act.

Subparagraph 127(11.1)(b)(i) is also amended to change the reference to subsection 125(1) to a reference to section 125. This extends the special 25 per cent investment tax credit for scientific research to research in a year carried on by any Canadian-controlled private corporation that qualifies for the small business deduction. Under the existing provision this special credit is not available in a year if the corporation has income in the year from a non-qualifying business. This amendment is applicable in respect of expenditures made after April 19, 1983.

Subclause 73(13)

ITA 127(12.2)

Subsection 127(12.2) is added to the Act as a consequence of the introduction of the three-year carryback for investment tax credits earned after April 19, 1983. The subsection applies where the investment tax credit earned in a year is carried back against taxes payable for a previous year. The effect of this provision is to ensure that the amount of the credit reduces the adjusted cost base of property in the year when the investment tax credit was earned and not in the earlier year in which the credit was claimed.

Subclauses 73(14) to (17)

These set out the effective dates for the amendments to section 127 of the Act dealing with tax credits.

Refundable Investment Tax Credit

Clause 74

Subclause 74 (1)

ITA 127.1

Section 127.1 is added to the Act to provide for the refundability of a portion of investment tax credits earned in the period commencing April 20, 1983 and ending April 30, 1986. The section provides for a refund for a taxation year of a stipulated percentage of the unused amount of such investment tax credit earned in the year.

For most Canadian-controlled private corporations, individuals and certain trusts, the stipulated percentage of credit that will qualify for a refund is 40 per cent. For all other taxpayers the stipulated percentage is 20 per cent. The amount refundable for a year is deemed to have been paid by the taxpayer on account of tax on the day on which his return of income is filed. Since the amount is deemed to have been paid by the taxpayer, it will offset any other liability he may have under the Act and will be refunded to him to the extent of any excess. Subsection 127.1(3) is to ensure that the amount of the refund for a year will reduce the investment tax credit pool that may be deducted by the taxpayer in subsequent years.

A prescribed form is required to be filed with respect to the refundable investment tax credit for a taxation year. This form is generally required to be filed with the tax return for the year but a special coming into force provision allows the form to be filed within 90 days following Royal Assent to the enacting Bill.

Special Recovery Share-Purchase Tax Credit
ITA 127.2

New section 127.2 of the Act, taken together with the new Part VII, provides the mechanism proposed in the April, 1983 budget to enable a corporation to "flow out" its investment tax credit to purchasers of qualifying new equity shares of the corporation. In effect, the investment tax credit of a corporation earned after April 19, 1983 becomes available to these shareholders in the form of a special share-purchase tax credit. This credit is then either deductible by the shareholders in calculating their liability for federal tax or refundable to them in the case of certain tax-exempt persons. To be eligible for the share-purchase tax credit, the qualifying shares must be issued after June 30, 1983 and before January 1, 1987.

ITA 127.2(1)

New subsection 127.2(1) of the Act permits a taxpayer to deduct from his Part I tax otherwise payable for a taxation year both his share-purchase tax credit for the year and his unused share-purchase tax credit for the following year. The amount of credit is determined under subsection 127.2(6).

ITA 127.2(2)

New subsection 127.2(2) sets out the rules for tax-exempt persons described in paragraphs 149(1)(e) to (y) of the Act such as registered pension funds, charities and certain other organizations. Because such persons are not taxable under Part I of the Act, the normal tax credit mechanism would not enable them to take advantage of their share-purchase tax credits. To overcome this difficulty, subsection 127.2(2) provides that, where any such person files the relevant prescribed form with its income tax return for the year, that person will be deemed to have paid, on the day the return is filed, an amount on account of Part I tax equal to its share-purchase tax credit. This ensures refundability of the share-purchase tax credit for these enumerated tax-exempt persons. The prescribed form described above is generally required to be filed with the tax return for the year but a special coming into force provision allows the form to be filed within 90 days following Royal Assent to the enacting Bill.

ITA 127.2(3)

New subsection 127.2(3) permits a trust to allocate its share-purchase tax credit to its beneficiaries rather than requiring the trust to claim the credit itself. The rules for this allocation are similar to the existing rules in subsection 127(7) for the allocation by a trust of its investment tax credit to beneficiairies. The allocation of the share-purchase tax credit among beneficiaries must be reasonable and the allocated amounts will qualify as share-purchase tax credits to the beneficiaries and will reduce the amount of the credit that the trust may itself claim. Where the taxation years of the trust and its beneficiaries do not coincide, the allocation is made as at the end of the trust's taxation year and the beneficiary obtains the credit for his taxation year then in progress.

ITA 127.2(4)

New subsection 127.2(4) deals with the share-purchase tax credit for partnerships. Since a partnership is not itself taxable, a new mechanism is required to allocate its credits to the partners. Under this subsection, a partner will include in his share-purchase tax credit for a taxation year the appropriate portion of the partnership's credit for its fiscal period that ends in the partner's taxation year.

ITA 127.2(5)

New subsection 127.2(5) deals with the share-purchase tax credit of cooperative corporations. Often these corporations have little or no taxable income because they have distributed or allocated their income by way of patronage dividends to members. To ensure that these corporations benefit from the share-purchase tax credit, this subsection permits a cooperative corporation to apply its share-purchase tax credit, as at the date of payment of patronage dividends, against its 15 per cent withholding tax liability in respect of these dividends. This special rule is similar to the existing rule for cooperatives in subsection 127(6) of the Act which permits the offset of investment tax credits against the withholding tax liability on patronage dividends. Any balance of the credit that is not applied against the withholding tax liability may be claimed by the cooperative corporation in the normal fashion as a tax credit against its Part I income tax liability.

ITA 127.2(6)

New subsection 127.2(6) defines a taxpayer's "share-purchase tax credit" and "unused share-purchase tax credit" for a taxation year.

A taxpayer's "share-purchase tax credit" consist of the sum of the amounts designated as credits under new subsection 192(4) of the Act by an issuing corporation in respect of each share acquired in the year by the taxpayer as the first registered holder thereof. (Note that an exception from the first registered holder requirements is made so as to qualify new shares purchased from a broker acting as a principal. Where the broker or dealer in securities is the first registered holder, the credit attaches to the first non-broker registered holder.) The share-purchase tax credit of a taxpayer also includes the credit allocated to the taxpayer as a beneficiary of a trust that acquired qualifying shares and his portion of the credit of any partnership of which he is a member. Any allocation of the share-purchase tax credits of a trust or partnership to beneficiaries or partners will reduce the amount of credits of the trust or partnership. As well, in the case of a cooperative corporation, the share-purchase tax credit must be reduced to the extent that the corporation has applied its credit against its withholding tax liability.

A taxpayer's "unused share-purchase tax credit" consists of that portion of his share-purchase tax credit for the year that could not be deducted by the taxpayer from his Part I tax otherwise payable for the year or applied to obtain his Part VII refund.

ITA 127.2(7)

New subsection 127.2(7) provides the definition of "tax otherwise payable" for purposes of the share-purchase tax credit. This definition ensures that the credit cannot be used to reduce the additional tax payable as a result of an election by an individual to forward average. The credit may, however, be claimed against tax payable arising as a result of an election to include in income amounts previously forward averaged. The share-purchase tax credit is to be applied against such tax before the special deduction allowed under section 120.1 of the Act in respect of the tax paid at the time of forward averaging.

ITA 127.2(8)

A taxpayer who acquires a share that is entitled to a share-purchase tax credit is deemed, under this subsection, to have acquired the share at a cost equal to the cost of the share otherwise determined minus the amount of the share-purchase tax credit in respect of the share.

Where the amount of the share-purchase tax credit exceeds the cost of the share (for example, where a property with low adjusted cost base and high fair market value is transferred to a corporation under subsection 85(1)) the excess will be treated either as a capital gain or income.

ITA 127.2(9)

New subsection 127.2(9) ensures that, although a partnership is not a person, its share-purchase tax credit will be determined in the same manner as though the partnership were a person.

Scientific Research Tax Credit

ITA 127.3

New section 127.3 of the Act, taken together with new Part VIII, provides the new financing mechanism proposed in the consultation paper "Research and Development Tax Policies" which was released with the April 19, 1983 budget. This mechanism will enable a corporation to renounce the tax benefit of deductions and related investment tax credits for scientific research expenditures and, by so doing, allow new investors to qualify for the new scientific research tax credit. The rates of this tax credit are set out in new subsection 127.3(2).

The scientific research tax credit is deductible by investors in calculating their liability for tax under Part I of the Act. To be eligible for the credit the investments must be in the form of shares, debt obligations or certain rights acquired after September, 1983. These investments are further described below. Where the investor is a corporation the credit is deductible either from its tax under Part I or against any liability that may arise under new Part VIII of the Act.

ITA 127.3(1)

New subsection 127.3(1) of the Act permits a taxpayer to deduct from his Part I tax otherwise payable for a taxation year both his scientific research tax credit for the year and his "unused scientific research tax credit" for the following year. The amount of the credit is determined under subsection 127.3(2).

ITA 127.3(2)

New subsection 127.3(2) defines a taxpayer's "scientific research tax credit" and "unused scientific research tax credit" for a taxation year. Where the investor is an individual, the scientific research tax credit is 34 per cent of the amount designated in respect of a qualifying investment made by him. In the case of a corporate investor, the credit is 50 per cent of the amount designated in respect of a qualifying investment made by it. The computation of provincial individual income taxes under federal-provincial tax collection agreements means that the 34 per cent scientific research tax credit rate for individuals will provide a total effective rate of credit for individuals of approximately 50 per cent, depending on the province.

Qualifying investments are shares or debt obligations issued, or rights granted under a scientific research financing contract by a corporation after September, 1983 where the investor is the first person (other than a broker or dealer in securities) to have acquired the share, debt obligation or right. For the purpose of this section, a debt obligation is a bond, debenture, bill, note, mortgage, hypothec or similar indebtedness. A scientific research financing contract, as defined in new subsection 194(6) of the Act, is a royalty agreement or other contract under which the investor becomes entitled to receive income other than interest or dividends.

A taxpayer's "unused scientific research tax credit" consists of that portion of his scientific research tax credit for the year that could not be deducted from his Part I tax otherwise payable for the year or applied to obtain his Part VIII refund.

ITA 127.3(3)

New subsection 127.3(3) sets out the rules for the allocation of the scientific research tax credit by a trust to its beneficiaries. A trust cannot itself claim the credit but under this new subsection may allocate scientific research tax credit to its beneficiaries. Where the taxation years of the trust and its beneficiaries do not coincide, the allocation is made as at the end of the trust's taxation year and the beneficiary obtains the credit for his taxation year then in progress.

ITA 127.3(4)

New subsection 127.3(4) sets out the rules for the allocation of the scientific research tax credit by a partnership to the members of the partnership. A partnership cannot itself claim the credit. However, under this subsection the members of the partnership are deemed to have earned the scientific research tax credit in their taxation year that includes the end of the fiscal period of the partnership in which it acquired the qualifying investment.

ITA 127.3(5)

New subsection 127.3(5) deals with the scientific research tax credit of a cooperative corporation. Often these corporations have little or no taxable income because they have distributed or allocated their income by way of patronage dividends to members. To ensure that such a corporation benefits from the scientific research tax credit, this subsection permits it to apply the credit, as at the date of the payment of the patronage dividends, against its withholding tax liability in respect of such dividends. Any balance of the credit that is not applied against the withholding tax liability may be claimed by the cooperative corporation in the normal fashion as a tax credit against its Part I income tax liability.

ITA 127.3(6)

New subsection 127.3(6) requires the cost to an investor of a qualifying investment that earns the scientific research tax credit to be reduced by 50 per cent of the designated amount. This cost reduction applies at the time of acquisition whether or not the scientific research tax credit is claimed. This ensures that if the qualifying investment is sold before the credit is claimed, the reduced cost will be used in determining any gain or loss.

ITA 127.3(7)

New subsection 127.3(7) provides that, although a partnership is not a person, it shall be treated as a person in determining whether it is the first person to acquire a qualifying investment and in determining the cost thereof.

ITA 127.3(8)

New subsection 127.3(8) provides that the scientific research tax credit cannot be used to reduce the additional tax payable as a result of an election by an individual to forward average. The credit may, however, be claimed against tax payable arising as a result of an election to include in income amounts previously forward averaged. The scientific research tax credit is applied against such tax before the special deduction allowed under section 120.1 of the Act in respect of the tax paid at the time of forward averaging.

Subclause 74(2)

This sets out the effective dates for new sections 127.1, 127.2 and 127.3 relating to refundable investment tax credits, the share-purchase tax credit and the scientific research tax credit. The coming-into-force provides that the prescribed forms as required by subsection 127.1(1) or 127.2(2) may be filed within ninety days after these subsections come into force.

Where Individual Bankrupt
ITA
128(2)(d.1)
and (d.2)

Clause 75

Subsection 128(2) of the Act sets out special rules where an individual becomes a bankrupt in a taxation year. New paragraphs 128(2)(d.1) and (d.2) provide special rules, effective after September 1983, where the bankrupt is, or was previously, a participant under an indexed security investment plan. Each indexed security investment plan under which the individual is currently a participant is deemed to have been terminated immediately before the time of his bankruptcy. The resulting gain or loss will be reflected in the individual's income for the taxation year ending immediately before the date of bankruptcy. Where the individual has unamortized capital losses arising out of a previously terminated indexed security investment plan under subsection 47.1(10), he will be deemed to have a capital loss for that year equal to the total of the amounts that would otherwise be capital losses from the plan for the year and subsequent years. The result of these amendments is an immediate acceleration of all capital gains and losses from all plans, including previously terminated plans, in the year of bankruptcy.

Dividend Refund to Private Corporations

Clause 76

Subclause 76(1)

ITA 129(1)(b)

The investment income of a corporation is taxed at the full corporate tax rate. A portion of this tax (referred to as "refundable dividend tax on hand") is refundable to Canadian-controlled private corporations upon payment of taxable dividends to their shareholders. This refundable tax mechanism is an integral part of what is generally referred to as "integration" for investment income which seeks to ensure that the tax paid by an individual on investment income and capital gains flowed through a Canadian-controlled private corporation approximates the tax that would have been payable if the income were received directly. Ordinarily the refund with respect to dividends paid in a year is made when the corporation's income for the year is assessed. Where the refund is not made at that time, under subsection 129(1) the corporation must make application therefor within four years from the end of the year to which it relates. The amendments to subsection 129(1) extend the four-year application period for refunds to seven years in certain circumstances and make the rules for dividend refunds consistent with the general rules in subsection 164(1) of the Act relating to ordinary tax refunds. The amendments to subsections 129(1) and 164(1) make the period within which tax refunds may be claimed consistent with the reassessment period provided in section 152 and are consequential on the amendments to that section. Under paragraph 129(1)(b) as amended, the normal four-year period for dividend refund applications is extended to seven years in circumstances where the corporation claims a deduction in a year in respect of a loss incurred or investment tax credit earned in a subsequent year.

This amendment also provides that the period in which a refund application for a year may be made commences with the day on which the notice of assessment for the year was mailed. Under the existing provision the four-year period runs from the last day of the year.

The amendments to subsection 129(1) are applicable after April 19, 1983.

Subclauses 76(2) and (3)

ITA 129(3)(a)

Paragraph 129(3)(a) of the Act defines the "refundable dividend tax on hand" of a private corporation. This represents the portion of tax on net investment income which is refunded to a private corporation on payment by it of dividends. Under the existing definition, net investment income is reduced by a taxpayer's deductible net capital losses carried over from other taxation years. The amendment to subsection 111(3) of the Act provides that a net capital loss carryover need no longer be claimed in the earliest year in which it is deductible, but may instead be preserved to be applied in computing taxable income in later years. The amendments to paragraph 129(3)(a) are consequential on this change. They provide that net investment income as determined under subclause 129(3)(a)(i)(B)(I) and subparagraph 129(3)(a)(ii) of the Act for purposes of calculating refundable dividend tax on hand is to be reduced by those net capital loss carryovers that are "deducted" rather than those "deductible" under paragraph 111(1)(b). This applies to losses determined for the 1983 and subsequent taxation years.

Subclauses 76(4) and (5)

ITA 129(4)(a)(i)

Subparagraph 129(4)(a)(i) of the Act excludes from the calculation of a corporation's refundable dividend tax on hand the portion of any capital gain or loss which accrued while the property disposed of was held by a corporation, other than a Canadian-controlled private corporation (CCPC). This rule would commonly apply where a CCPC disposes of capital property which it owned during a period of time when it was not a CCPC or which it acquired from another corporation, other than a CCPC, on a tax-deferred "rollover" basis. These amendments provide that the amount of such gains or losses which accrued while the property disposed of was owned by an investment corporation, a mortgage investment corporation or a mutual fund corporation, as well as a CCPC, will be included in the computation of refundable dividend tax on hand. This amendment applies in respect of property disposed of after November 12, 1981, except where such property is exempt from these rules by virtue of transitional rules.

Subclause 76(6)

ITA 129(4.3)

Subsection 129(4.3) of the Act is a transitional rule which provides in effect that the tax payable by a corporation on the gain from a disposition of "designated property", including any portion of the gain which accrued while the property was owned by a corporation other than a Canadian-controlled private corporation (CCPC), will continue to be included in the computation of its refundable dividend tax on hand. Under the existing provision designated property is defined as property acquired before November 13, 1981 by a corporation that last became a CCPC before that date. This amendment deletes the reference to "Canadian-controlled" so that, effective after November 12, 1981, designated property includes any property acquired by a corporation on or before that date if it last became a private corporation on or before that date. For this purpose, the expression "private corporation" has the meaning set out in paragraph 89(1)(f) of the Act.

Subclauses 76(7) to (10)

These set out the effective dates for the amendments to section 129 of the Act.

Investment Corporations
ITA
130(3)(b)(i)

Clause 77

The Income Tax Act provide a mechanism to avoid an extra level of tax on income and capital gains earned by certain investment intermediaries on behalf of investors. The avoidance of the double tax, or integration, in respect of the tax on capital gains of investment corporations, mutual fund corporations and mutual fund trusts, taxable under sections 130, 131 and 132 of the Act respectively, is achieved by refunding the tax paid by them on their net taxable capital gains at such time as the gains are distributed to their investors. Section 130.1 achieves integration for the capital gains of a mortgage investment corporation by permitting a deduction from income equal to the amount of net taxable capital gains distributed by way of dividends to shareholders. Net taxable capital gains, which for the purposes of these sections are defined as "taxed capital gains" in paragraph 130(3)(b) of the Act, is reduced by deductible net capital losses carried over from other taxation years. The amendment to subsection 111(3) of the Act provides that a net capital loss carryover need no longer be claimed under paragraph 111(1)(b) in the earliest year in which it is deductible, but may instead be preserved to be applied in computing taxable income in later years. The amendment to subparagraph 130(3)(b)(i) is consequential on this change. It provides that taxed capital gains shall be reduced by those net capital loss carryovers that are "deducted" rather than those that are "deductible" under paragraph 111(1)(b). This applies to losses determined for the 1983 and subsequent taxation years.

Capital Gains Dividend of Mutual Fund Corporation
ITA
131(1)(b)

Clause 78

Paragraph 131(1)(b) provides that any amount received by a taxpayer as a capital gains dividend from a mutual fund corporation will be treated as a capital gain of the taxpayer from the disposition of capital property rather than as a dividend. The amendment to paragraph 131(1)(b) is consequential on new subsection 47.1(18) which provides that a capital gains dividend received after September, 1983 by a taxpayer on a share of a mutual fund corporation owned under an indexed security investment plan is to be treated as proceeds of disposition rather than as a capital gain.

Non-Resident-Owned Investment Corporations
ITA
133(2)(c)

Clause 79

A non-resident-owned investment corporation is subject to tax which approximates that which would have been payable if its non-resident shareholders had invested in Canada directly rather than through the corporation. Paragraph 133(2)(c) of the Act provides for the deduction of net capital loss carryovers in computing the taxable income of a non-resident-owned investment corporation. Under the amended subsection 111(1) of the Act, a taxpayer is permitted a deduction in computing taxable income for a taxation year of his net capital losses for the three following years. Under the existing provision a net capital loss can be carried back for only one taxation year. The amendment to paragraph 133(2)(c) is strictly consequential on this extension of the carryback period and deletes the reference to the period over which net capital losses may be deducted. For the 1982 and subsequent taxation years the reference in this paragraph is to the net capital losses as provided in section 111.

Life Insurers Change of Use Rules
ITA
138(11.3)

Clause 80

Subsection 138(11.3) of the Act provides for a deemed disposition and reacquisition at fair market value of an insurer's property the use of which has changed between an insurance business in Canada and some other purpose. Exceptions to this change-in-use rule currently exist in respect of the recaptured depreciation provisions and the regulations concerning the Canadian Investment Fund. The amendment, applicable to changes in use occurring in taxation years commencing after November 12, 1981, provides a further exception so that the insurer can ignore the subsection 138(11.3) adjustment to the cost of the property in calculating the amortization of a premium, the accrual of a discount and the claiming of an investment reserve in respect of Canada securities.

Segregated Funds

Clause 81

Subclause 81(1)

ITA
138.1(1)(a)

Section 138.1 of the Act provides rules governing the operation of related segregated fund trusts established by insurance companies. The amendment to paragraph 138.1(1)(a) provides that the definition "related segregated fund trust" is also relevant for the purpose of section 47.1 relating to indexed security investment plans.

Subclause 81(2)

ITA
138.1(1)(k) and (l)

The amendment to paragraph 138.1(1)(k) and the introduction of new paragraph 138.1(1)(l) are strictly consequential on the new provisions relating to share-purchase tax credits. New paragraph 138.1(1)(l) ensures that where an insurer acquires a share for the benefit of a segregated fund trust, the trust and not the insurer will qualify for the share-purchase tax credit even though the share would normally be registered under the insurer's name. The amendment to paragraph 138.1(1)(k) simply adds a reference to the provisions of the Act relating to the share-purchase tax credits of trusts.

Subclauses 81(3) and (4)

These set out the effective dates of the amendments to section 138.1 of the Act.

Cross Reference

ITA
146, 146.2
146.3, and 147

The coming into force provision governing the restriction of certain ancillary benefits of deferred income plans are amended by clauses 114 to 117 (see commentary thereunder).

Registered Home Ownership Savings Plan

Clause 82

Subclause 82(1)

ITA 146.2(1)(c)

Paragraph 146.2(1)(c) of the Act provides the definition of "home furnishings" for the purposes of the registered home ownership savings plan program. This definition has had no application since 1977, when it ceased to be permissible to withdraw funds from such plans on a tax-free basis to purchase home furnishings. However, to implement the April 19, 1983 budget proposal permitting withdrawals for the purchase of certain new home furnishings, a special definition of "new home furnishings" is substituted for that in paragraph 146.2(1)(c) by virtue of the special transitional rule in subclause 82(7) of the Bill. This special definition applies only for the 1983 and 1984 taxation years, after which paragraph 146.2(1)(c) will be repealed.

Subclause 82(2)

ITA 146.2(2)(f)

An individual who has been a beneficiary under a registered home ownership savings plan is not permitted by virtue of paragraph 146.2(2)(f) of the Act to open another plan. This rule is extended to an individual who has never been a beneficiary under such a plan but has claimed the new top-up deduction, provided under amended subsection 146.2(4), since it is not necessary to open a plan in order to take advantage of this special deduction.

Subclause 82(3)

ITA 146.2(4)

Subsection 146.2(4) of the Act permits a maximum annual deduction of $1,000 in respect of contributions made to a registered home ownership savings plan with an overall contribution limit of $10,000. It is now proposed that a beneficiary under a registered home ownership savings plan be permitted a special "top-up" deduction in 1983 or 1984 for the unused portion of his $10,000 contribution limit. This special "top-up" deduction is available in those circumstances where the taxpayer uses the funds in his plan in the year or within 60 days after the end of the year to acquire or build a new housing unit provided that neither he nor his spouse previously owned a dwelling after 1981, no other person claims a similar deduction in respect of the same housing unit and no grant is payable under the National Housing Act in respect of that housing unit. In order to benefit from the top-up deduction, an individual who is not already a beneficiary under such a plan does not have to open a plan—it is sufficient that he establish he was eligible to open such a plan.

Subclauses 82(4) and (5)

ITA 146.2(6)(a)

Paragraph 146.2(6)(a) of the Act enables a beneficiary under a plan to receive tax-free amounts from his plan to the extent they are used to acquire an owner-occupied home. Under the amendments this tax-free treatment will be extended to amounts received after April 19, 1983 and before 1984 by an individual who was, on April 19, 1983, a beneficiary under a registered home ownership savings plan to the extent that amounts equivalent to the amounts withdrawn are used by him no later than February 29, 1984 to purchase new home furnishings for his own use in Canada. Receipts must be filed in support of the purchase and the exempt amounts reduce the amount of any deductible contribution to any such plan that may be made by the taxpayer after April 19, 1983 and in that year. The definition of "new home furnishings" is provided in paragraph 146.2(1)(c) as set out in subclause 82(7) of the Bill.

Subclause 82(6)

ITA 146.2(21)

The existing rules relating to registered home ownership savings plans do not allow for partial withdrawals of funds. Such withdrawals would normally cause the revocation of the plan. This rule is changed in order to enable an individual who was, on April 19, 1983, a beneficiary under a plan to withdraw tax free, after that date and before 1984, part or all of the funds from the plan in order to purchase qualifying new home furnishings without causing its revocation.

Subclauses 82(7) and (8)

These set out the effective dates for the amendments to section 146.2 of the Act relating to registered home ownership savings plans.

Adjusted Cost Basis of Life Insurance Policy and Annuity

Clause 83

Subclauses 83(1) to (3)

ITA 148(9)(a)(v.1), (ix) and (xi)

Subparagraphs 148(9)(a)(v.1), (ix) and (xi) of the Act provide for adjustments to the cost basis of a life insurance policy for the net cost of pure insurance and for adjustments to the cost basis of a life annuity contract for mortality gains and mortality losses. A mortality gain reflects the increased value that the holder of a life annuity acquires when the annuitants under other life annuities with the same issuer die, while a mortality loss reflects the decrease in such value that occurs when an annuitant under the contract dies. Net cost of pure insurance is the insurance element of the cost of a life insurance policy and is to be deducted in computing adjusted cost basis in taxation years commencing after May 31, 1985 in respect of policies acquired after December 1, 1982. The amendments to these subparagraphs provide the appropriate authority for determining these adjustments under the Income Tax Regulations. The amendments apply for taxation years commencing after 1982.

Subclause 83(4)

This subclause ensures that authority exists as of January 1, 1983 for the regulations which were made on November 17, 1983 pursuant to the amendments to paragraph 148(9)(a) of the Act.

Subclause 83(5)

This sets out the effective date for the amendments to section 148 of the Act.

Clause 84

Subclause 84(1)

ITA
149(1)(o.2)(iv)

Paragraph 149(1)(o.2) of the Act exempts from tax certain types of corporations involved with pension fund administration and investments if all the shares and rights to acquire shares of the corporation are owned by, or in certain cases held exclusively for the benefit of, one or more registered pension plans. The paragraph is amended by adding clause (iv)(D) to provide that a corporation may also qualify for tax-exempt status when its shares are held by one or more prescribed persons. This will allow for regulations to be made to accommodate different forms of ownership of such corporations where they are nonetheless established for the exclusive benefit of registered pension plans. This amendment is applicable to taxation years commencing after 1978.

Subclause 84(2)

ITA
149(5)(f)(ii)

Subsection 149(5) of the Act sets out specific rules for the taxation of certain clubs, societies and associations. This provision denies them the $100 optional standard deduction under paragraph 110(1)(d). The amendment to subparagraph 149(5)(f)(ii) removes the reference to paragraph 110(1)(d) and is strictly consequential on the repeal of that deduction. This amendment applies to the 1984 and subsequent taxation years.

Subclause 84(3)

ITA
149(5)

Subsection 149(5) of the Act subjects to tax the investment income of certain clubs providing dining, recreational or sporting facilities. Subsection 149(5) is amended to repeal paragraph 149(5)(h). This paragraph dealt with the former Part VII of the Act relating to dividends paid out of designated surplus which was repealed in 1977, and this amendment simply removes a reference to a provision that no longer exists.

Subclauses 84(4) and (5)

These set out the effective dates for the amendments to section 149 of the Act.

Assessments

Clause 85

Subclause 85 (1)

ITA 152(1)(b)

Paragraph 152(1)(b) of the Act requires the Minister of National Revenue, in assessing tax for a year, to take into account the amount of tax which has been deemed to have been paid by a taxpayer under certain provisions of the Act. The amendment to paragraph 152(1)(b) adds references to subsections 119(2) and 144(9) and to new subsections 127.1(1) and 127.2(2). Subsection 119(2) relates to block averaging for farmers and fishermen. Subsection 144(9) provides for a special 15 per cent tax credit when an employee ceases to be a beneficiary under an employee's profit sharing plan. Subsection 127.1(1) relates to the refundable portion of the investment tax credit and subsection 127.2(2) relates to the new share-purchase tax credit earned by non-taxable entities such as pension plans. This amendment applies to the 1983 and subsequent taxation years.

Subclause 85 (2)

ITA 152(1.1) to (1.3)

Subsections 152(1.1) to (1.3) of the Act set out rules which apply where the Minister of National Revenue does not agree with the amount of a non-capital loss, net capital loss or restricted farm loss reported by a taxpayer. The Minister is required, at the taxpayer's request, to make a determination of the amount of the loss. This determination is subject to the taxpayer's rights of objection and appeal. The amendments to subsections 152(1.1) to (1.3) are consequential on the introduction of the new provisions in section 111 related to farm losses. For the 1983 and subsequent taxation years, the rules in these provisions are extended to farm losses as defined in new paragraph 111(8)(b.1).

Subclause 85 (3)

ITA 152(4)

Existing subsection 152(4) of the Act provides that in the absence of fraud or misrepresentation the Minister of National Revenue may not assess or reassess tax, interest or penalties after four years from the day of mailing the original notice of assessment. This amendment extends the four-year reassessment period to seven years in certain circumstances. The need for the amendment arises out of the extension of the carryback period for losses and investment tax credits.

Paragraph 152(4)(b) of the Act is amended to permit the Minister to assess or reassess tax within seven years where the assessment or reassessment for a year requires an adjustment described in subsection 152(6), such as the carry back of a loss or an investment tax credit from a subsequent year. Thus, for example, if a non-capital loss for 1984 is claimed by a taxpayer in 1981 and, within seven years from the date of mailing the original notice of assessment for 1981 it is determined that the actual amount of that loss is less than the amount claimed, the Minister may reassess the 1981 year to the extent that the reassessment relates to the adjustment of the loss carryback. Under subparagraph 152(4)(b)(ii) the Minister is also permitted to assess or reassess a taxpayer whose tax position is affected by the loss of another taxpayer. For example, an adjustment to the amount of a corporation's loss carryover could alter its liability for tax under Part II of the Act or the amount of its dividend refund. This, in turn, could change the tax position of certain corporate shareholders. Any reassessment under the seven year rule is confined to matters that relate to a deduction described in subsection 152(6) of the Act. The amendments to subsection 152(4) of the Act are applicable after April 19, 1983.

Subclause 85(4)

ITA 152(6)

Subsection 152(6) of the Act provides for the reasssessment of a taxpayer's tax for a taxation year where the taxpayer files a prescribed form claiming a deduction for a loss of the subsequent taxation year. The amendments to this provision are made necessary by the extension of the loss carryback period and the introduction of a three-year carryback for investment tax credits and a one year carryback for the unused share-purchase tax credit and the unused scientific research tax credit. Subsection 152(6) is amended to provide that where a taxpayer has filed a prescribed form claiming a deduction in respect of a loss, gift, investment tax credit or unused share-purchase tax credit or unused scientific research tax credit of a subsequent taxation year, the Minister of National Revenue shall reassess all relevant taxation years of the taxpayer to give effect to the deduction claimed. The provision requires that the prescribed form claiming the carryback be filed by the due date for the taxpayer's return of income for the year from which the carryback is made. The amendments to subsection 152(6) are applicable after April 19, 1983.

Subclauses 85(5) and (6)

These set out the effective dates for the amendments to section 152 of the Act and provide for an extension of the time for filing the prescribed forms required by subsection 152(6) where a taxation year ends before these amendments are enacted.

Overpayment of Certain Tax Credits
ITA
160.1

Clause 86

Section 160.1 of the Act ensures that the Minister of National Revenue can recover any excess child tax credits refunded to a taxpayer for a taxation year. The taxpayer is also liable for interest on the excess calculated from the later of the day on which the taxpayer filed his tax return for the year and the day that is the earlier of November 30 of the following year and the day the Minister determined that too much had been refunded.

The amendments to subsection 160.1(1), applicable with respect to amounts refunded after 1983, extend the scope of the subsection to permit the Minister to recover any other refund made as a result of an excess credit claimed by a taxpayer under the provisions relating to block averaging for farmers and fishermen, the Quebec tax abatement, employees profit sharing plans, the new refundable investment tax credit, the new share-purchase tax credit, the new scientific research tax credit and certain special refundable taxes paid by private corporations, mutual funds and non-resident-owned investment corporations. In addition, the amendments provide that interest on the excess refund is to be calculated at the prescribed rate for the period beginning on the day on which the overpayment was made and ending on the day the excess is recovered.

The amendment to subsection 160.1(2) is applicable to amounts refunded after 1983 and is consequential on the changes made to the child tax credit in section 122.2 of the Act. As amended, subsection 160.1(2) provides that where an individual with a child eligible for the credit resides with a supporting person of that child, both the individual and the supporting person will be jointly and severally liable for any excess credit that has been refunded together with the interest payable thereon.

Subsection 160.1(3) provides the authority for the Minister to make an assessment to recover excess credits and the interest thereon. The amendments to this provision are strictly consequential on the amendments to extend the scope of subsection 160.1(1).

Interest on Unpaid Taxes

Clause 87

Section 161 of the Act relates to interest on unpaid taxes and on late or deficient tax instalments.

Subclause 87(1)

ITA 161(1)

Subsection 161(1) of the Act provides that interest is payable by a taxpayer on the excess of his tax payable for a taxation year over the amount paid for the year. However, this subsection, as presently worded, does not require interest where taxes have been paid, some portion thereof has been refunded and in a subsequent assessment it is determined that the refund was excessive having regard to the taxpayer's subsequently determined tax liability. The amendment to subsection 161(1) corrects this deficiency by ensuring that interest at the prescribed rate will be payable where a refund is later determined to have been in excess of the amount to which the taxpayer is entitled. The interest will be calculated only for the period after April 19, 1983.

Subclause 87(2)

ITA 161(7)

The amendments to subsection 161(7) of the Act are consequential on the changes to the provisions relating to the carryback of losses and investment tax credits and the introduction of the new share-purchase tax credit and scientific research tax credit. Under the existing provision, where the tax payable for a year is reduced because of the carryback of a loss for a subsequent year, the interest on unpaid tax is calculated, without regard to the loss carryback, for the period to the end of the year in which the loss was incurred. Subsection 161(7) as amended applies where a deduction in respect of a gift, an exclusion of income in consequence of the exercise of an option, a loss, an investment tax credit, or unused share-purchase tax credit or scientific research tax credit is carried back from a subsequent taxation year to reduce the tax payable for a taxation year. It provides that in calculating any interest due on unpaid tax for that year, the tax reduction resulting from the carryback is deemed to be made on the later of the day on or before which the tax return for the subsequent year is required to be filed and the day on which the return is actually filed. This amendment is applicable where an amount is carried back from the 1983 or a subsequent taxation year. Where, however, the later year in which an amount arose ended before April 20, 1983 interest on unpaid tax for a year to which the amount is carried back will be calculated from the end of the later year.

Subclauses 87(3) and (4)

These set out the effective dates for the amendments to section 161 of the Act relating to the computation of interest.

Penalties

Clause 88

ITA
163(2)(b), (c) and (d)

Subsection 163(2) of the Act provides that, where any person has knowingly, or under circumstances amounting to gross negligence, participated in the making of a false statement in a tax return which would, if accepted, result in the reduction of tax payable, he is liable to a penalty of 25 per cent of the amount of the reduction.

Where false information has been filed which overstates a claim for the child tax credit, paragraph 163(2)(b) provides that both the individual making the claim and his spouse may be subject to the penalty. The amendment to paragraph (b) thereof is consequential on the changes in section 122.2 of the Act relating to the child tax credit.

The amendment provides that both the individual and any person residing with him who is a supporting person of an eligible child of the individual are subject to the penalty with respect to an improper claim for the child tax credit.

New paragraphs 163(2)(c) and (d) have been added to extend the penalty provisions to false statements made in respect of the refundable investment tax credit and the refundable share-purchase tax credit in subsection 127.1(1) and 127.2(2) respectively. These amendments are applicable to the 1983 and subsequent taxation years.

Clause 89

Subclause 89(1)

ITA
164(1)(b)

Section 164 of the Act relates to tax refunds. Subsection 164(1) provides that the Minister of National Revenue may refund an overpayment for tax for a year upon mailing the notice of assessment for the year. Where a refund has not been made in this manner a taxpayer may make application therefor within four years from the end of the year. The amendments to this subsection make the period within which tax refunds may be claimed consistent with the assessment period provided in section 152. The amendments to subsection 152(4) extend the reassessment period from four to seven years where the tax liability is to be adjusted as a result of a claim or losses incurred or investment tax credits earned in a subsequent year. A corresponding change is made to paragraph 164(1)(b) so that the normal four year period for refund applications is extended to seven years in circumstances where the taxpayer claims a deduction in respect of a subsequent year's loss or investment tax credit.

This amendment also provides that the normal four year period in which a refund application may be made for a year commences on the day on which the original notice of assessment for the year was mailed. Under the existing provision the period for claiming a refund runs from the last day of the year. In addition, paragraph 164(1)(b) as amended places an obligation on the Minister of National Revenue to pay a refund for which application has been made within a reasonable time.

The amendments to paragraph 164(1)(b) of the Act are applicable after April 19, 1983.

Subclause 89(2)

ITA
164(3.1)

Subsection 164(3) of the Act provides that interest at the prescribed rate will be paid to a taxpayer on the amount of an overpayment of his Part I tax liability. It provides also that, instead of being paid, the interest may be applied against another tax liability of the taxpayer. New subsection 164(3.1) applies where interest has been paid or applied after April 19, 1983 on the refund of an overpayment of tax and it is subsequently determined that the overpayment was in excess of the amount to which the taxpayer was entitled. Paragraph 164(3.1)(a) provides for the recovery of interest from the taxpayer to the extent that the amount of interest paid exceeds the amount of interest payable on the refund to which he is entitled. Paragraph 164(3.1)(b) provides for the payment by the taxpayer of interest on any excess interest that had previously been paid to him or applied against another of his tax liabilities.

Subclause 89(3)

ITA
164(5)

The amendments to subsection 164(5) of the Act are consequential on the extension of the loss carryback period, the introduction of the investment tax credit carryback and the one year carryback for the new share-purchase tax credit and scientific research tax credit. Under the existing provision, to the extent that an overpayment of tax results from a loss carryback, the interest payable on the overpayment is calculated for the period commencing immediately after the taxation year in which the loss arose. Subsection 164(5) as amended applies where a deduction in respect of a gift, an exclusion from income in consequence of the exercise of an option, a loss, an investment tax credit, unused share-purchase tax credit or unused scientific research tax credit is carried back from a subsequent taxation year to reduce the tax payable for a previous taxation year. It provides that in calculating any interest payable on an overpayment of taxes, the tax reduction resulting from the carryback is deemed to be made on the later of the day on or before which the tax return for the subsequent taxation year is required to be filed and the day on which the return is actually filed. This amendment is applicable where an amount is carried back from the 1983 or a subsequent taxation year. Where, however, the later year in which an amount arose ended before April 20, 1983 interest payable on any resulting overpayment of tax will be calculated from the end of the later year.

Subclause 89(4)

ITA 164(6)

Subsection 164(6) of the Act sets out special rules for the situation where the estate of a deceased person realizes a capital loss or terminal loss from the disposition of property in its first taxation year. In these circumstances the legal representative of the deceased person may elect to ignore all or any portion of the capital loss (to the extent that the estate's capital losses exceed its capital gains for that year) and all or any portion of the terminal loss (to the extent of the estate's non-capital loss for that year). In this case, these losses are not treated as losses of the estate, in which event the estate is credited on account of its taxes payable with the amount by which the deceased taxpayer's tax would have been reduced if such amounts had been deductible by him in the year of his death. The amendments to subsection 164(6) are strictly consequential on the introduction of the new rules in section 111 relating to farm losses. Subsection 164(6) as amended provides that for the 1983 and subsequent taxation years, the amount of a terminal loss in respect of which an election can be made cannot exceed the aggregate of the estate's non-capital loss and farm loss for its first taxation year. Since farm losses have been excluded from non-capital losses, the effect is to continue the existing rule.

Subclause 89(5)

ITA 164(7)

Subsection 164(7) of the Act defines "overpayment" for the purpose of determining the amount of the refund of taxes to which a taxpayer is entitled and the interest thereon. Subsection 164(7) is amended for the 1983 and subsequent taxation years to clarify that an overpayment is calculated on a year-by-year basis and with respect to taxes payable under Part I of the Act.

Subclauses 89(6) to (9)

These set out the effective dates for the amendments to section 164 of the Act relating to refunds.

Reference to Federal Court

ITA
173(2)(a)

Clause 90

Under subsection 173(1) of the Act the Minister of National Revenue and a taxpayer may agree to refer a question of law, fact or mixed law and fact arising under the Act to the Federal Court. The amendment to this section is strictly consequential on the extension of the reassessment period to seven years where the tax liability for a year of a taxpayer is affected by the carryback of losses or investment tax credits of subsequent years. Paragraph 173(2)(a) of the existing Act provides that the period of time during which any question is being considered by the Court shall not be included in computing the four-year period provided for reassessment of tax under subsection 152(4). The amendment, applicable after April 19, 1983, adds a reference to the new seven-year period for reassessments provided under the amendments to subsection 152(4).

Reference of Common Questions
ITA
174(5)(c)

Clause 91

Section 174 of the Act permits the Minister of National Revenue to refer a question of law, fact or mixed law and fact that is common to the assessments of two or more taxpayers to the Tax Court of Canada or, with the concurrence of the taxpayers involved, to the Federal Court of Canada—Trial Division for a determination. Paragraph 174(5)(c) removes the period during which the question is being determined from the computation of the four-year period referred to in subsection 152(4) during which a reassessment of tax may be made. The amendment to paragraph 174(5)(c) is strictly consequential on the extension of the reassessment period to seven years where the tax liability for a year of a taxpayer is affected by the carryback of a loss or investment tax credit of a subsequent year. The amendment, applicable after April 19, 1983, adds a reference to the new seven-year period for reassessments provided in the amendments to subsection 152(4).

Part III Tax on Excessive Election
ITA
184(3) and
185(1) and (2)

Clauses 92 and 93

Sections 184 and 185 of the Act provide for a special tax to be paid by a corporation that elects to pay an excessive capital dividend pursuant to subsection 83(2), life insurance capital dividend pursuant to subsection 83(2.1) or capital gains dividend pursuant to subsections 130.1(4) or 131(1). As an alternative, subsection 184(3) provides a mechanism to allow a corporation to elect to treat the excess amount of dividend as a taxable dividend. The amendment to paragraph 184(3)(b), applicable after March 29, 1983, adds a reference to subsection 83(2) which was inadvertently removed when the paragraph was last amended. Subsections 185(1) and (2), which provide for the assessment and payment of Part III tax, are amended to extend their application to excessive elections in respect of life insurance capital dividends. These amendments, to be effective upon Royal Assent to the Bill, are strictly consequential on the extension of the Part III tax to life insurance capital dividends.

Part IV Tax on Dividends

Clause 94

The purpose of the 25 per cent tax imposed under Part IV of the Act on dividends received by private corporations and certain non-private "subject corporations" is to prevent an individual from benefitting from the deferral of tax that would otherwise be possible if, instead of receiving dividends directly, he arranged for his investment in shares to be held by a corporation. Because dividends are generally permitted to pass between corporations on a tax-free basis, the interposition of a corporation would, in the absence of the tax under Part IV, allow dividends on the shareholdings to be received free of tax. This tax is fully refunded to the corporation upon the payment of taxable dividends to its shareholders.

Subclause 94(1)

ITA 186(1)(c) and (d)

Paragraph 186(1)(c) of the Act permits a corporation to deduct the amount of its non-capital loss incurred in a taxation year from its Part IV tax base for that year. This provision is amended to provide for the deduction under Part IV of a corporation's farm loss for a taxation year as defined in new paragraph 111(8)(b.1) of the Act.

Under existing paragraph 186(1)(d), a corporation may elect to reduce its Part IV tax base by the amount of its non-capital losses for the 5 taxation years immediately preceding and the taxation year immediately following the year in which the losses are claimed. Non-capital losses may be deducted under Part IV only to the extent that they cannot be absorbed in computing taxable income under Part I and only if the corporation was a private corporation or subject corporation during the year in which the loss was incurred.

The amendment to paragraph 186(1)(d) provides that a corporation's farm losses will be available for deduction under Part IV and that the extended carryover periods provided in amended subsection 111(1) will apply equally for the purposes of paragraph 186(1)(d). This amendment also provides that a corporation's non-capital losses and farm losses for a taxation year during which it was neither a private corporation nor a subject corporation may be carried over to be applied under Part IV and that losses need no longer be deducted first in computing taxable income under Part I of the Act, but rather may be used, where it is to the corporation's advantage, to reduce its Part IV tax liability.

Subparagraph 111(3)(a)(ii) of the Act provides that non-capital losses and farm losses applied under paragraphs 186(1)(c) and (d) are not available to be carried over to be deducted in computing taxable income for other taxation years.

Subclause 94(2)

ITA 186(4)(a)

When a corporation in receipt of a dividend controls the corporation paying the dividend, the Part IV tax may not apply. A special definition of control is provided for this purpose in subsection 186(2) of the Act such that the holder of a right to acquire shares may qualify as a controller. The amendment to paragraph 186(4)(a) provides that, for the purpose of the Part IV tax, whether a payer corporation is controlled by another corporation is to be determined by reference to the actual ownership of shares and without regard to any right referred to in paragraph 251(5)(b) to acquire shares. This amendment prevents the avoidance of Part IV tax by arranging for non-controlling shareholders to obtain rights to purchase shares. This change is effective with respect to dividends declared and paid after April 19, 1983.

Subclauses 94(3) and (4)

These set out the effective dates for the amendments to section 186 relating to the Part IV tax.

Corporations Exempt From Part IV Tax
ITA
186.1(b)

Clause 95

Section 186.1 of the Act exempts certain corporations from the 25 per cent refundable tax payable under Part IV. The amendment to paragraph 186.1(b) expands the number of corporations that are exempted from the Part IV tax.

A number of the recently established foreign-controlled banks qualify as private corporations and, as a consequence, would be inappropriately subjected to the tax under Part IV under the existing rules. The existing exemption for certain financial institutions (trust companies, insurance corporations, prescribed venture capital corporations and prescribed investment contract corporations) is expanded to exclude all banks from the scope of the Part IV tax.

Under the existing provisions, a non-resident-owned investment corporation is liable to a 25 per cent refundable tax on its dividend income under section 133 of the Act. Where such a corporation is controlled by an individual or a related group of individuals it would also be liable to Part IV tax on the same income. In order to prevent this double taxation, the amendment also exempts non-resident-owned investment corporations from the Part IV tax. The amendments to section 186.1 are generally applicable to taxation years commencing after November 12, 1981.

Tax on Corporation Issuing Qualifying Shares

Clause 96

This clause sets out the new Parts VII and VIII of the Act which, in conjunction with the new share-purchase and scientific research tax credits under sections 127.2 and 127.3, provide mechanisms for the "flow out" from corporations of the investment tax credit and scientific research tax benefits to investors.

Part VII

New Part VII of the Act, taken together with new section 127.2, provides the mechanism announced in the April 1983 budget to enable a corporation to "flow out" its investment tax credit to purchasers of qualifying new equity shares of the corporation. New Part VII, consisting of sections 192 and 193, provides for a refundable tax payable annually by corporations that flow out these credits, called "share-purchase tax credits", to the purchasers of qualifying new shares. The refundable tax payable by a corporation is designed to fund the share-purchase tax credit that it allocates to persons who acquire the shares. Thus, the aggregate credit allocated by the corporation is included in the computation of its Part VII refundable tax liability for the year. In turn, however, this Part VII tax liability may be offset by a refund equivalent to any unclaimed investment tax credit earned by the corporation after April 19, 1983 and before the end of the year. Thus the corporation may issue shares that carry the share-purchase tax credit even though it has not at the time of issue made the necessary expenditures that earn the investment tax credit. In addition, the corporation may offset its Part VII tax liability by any unclaimed share-purchase tax credit that has been designated to it in respect of any qualifying shares of another corporation that it has purchased in the year. After application of these offsets or refunds, the corporation is required to pay the balance of the Part VII tax. However, any balance so paid is refundable in subsequent taxation years when investment tax or share-purchase tax credits are earned.

ITA 192(1)

New subsection 192(1) of the Act imposes the Part VII tax liability on a corporation which has issued shares in respect of which the purchaser is entitled to the share-purchase tax credit. The corporation's liability for the Part VII tax in a year is equal to the amounts designated by it under new subsection 192(4) in respect of shares issued by it in the year. However, the Part VII tax payable in a year by a corporation may be refunded to the extent of the sum of any unclaimed investment tax credit on expenditures made or property acquired by the corporation after April 19, 1983 and before the end of the year and any unclaimed share-purchase tax credit on shares of another corporation acquired in the year. Any balance of the Part VII tax for a year must be paid but may be refunded in a subsequent taxation year to the extent of such unclaimed share-purchase and investment tax credits at the end of that subsequent year.

ITA 192(2)

New subsection 192(2) of the Act defines the "Part VII refund". Technically the Part VII refund is the lesser of two amounts:

The first amount is the sum of:

— the corporation's share-purchase tax credit for the year that was not deducted from its Part I tax (or, in the case of a tax-exempt corporation, was not deemed to have been paid on account of its Part I tax), and

— such amount as the corporation chooses to claim of its investment tax credit at the end of the year in respect of an expenditure made or property acquired after April 19, 1983 and before the end of the year.

The second amount is the corporation's "refundable Part VII tax on hand" at the end of the year as defined in subsection 192(3).

ITA 192(3)

New subsection 192(3) of the Act defines a corporation's "refundable Part VII tax on hand" at the end of a taxation year. This amount represents the maximum refund of the Part VII tax to which a corporation is entitled in a year. It consists of the total of the Part VII taxes payable by the corporation in the year and in all preceding years minus the sum of its Part VII refunds for all preceding years and any Part VII tax payable in respect of a share that was not, at the time of issuance, a qualifying share as defined in new subsection 192(6). In other words, the "refundable Part VII tax on hand" represents the unrefunded Part VII tax paid minus any Part VII tax paid in respect of a subsection 192(4) designation made on a share that was not a qualifying new equity share. This prevents refunds from being granted with respect to the issuance of such non-qualifying shares.

ITA 192(4)

A corporation that wishes to flow out share-purchase tax credits on the issue of a share is required under new subsection 192(4) of the Act to designate the amount of the credit in respect of the share. No designation under this subsection is permitted where a scientific research tax credit designation has been made under new subsection 194(4) in respect of the share. The amount designated under subsection 192(4) cannot exceed 25 per cent of the amount by which the value of the consideration for which the corporation issued the share exceeds any government assistance for the purchase of the share that the purchaser is entitled to receive. The corporation must make the designation by filing certain prescribed information before the end of the month following the month in which the share is issued or within 90 days following Royal Assent to the Bill.

ITA 192(5)

New subsection 192(5) of the Act provides that a corporation's Part VII refund for a taxation year will be considered to have been paid as an amount on account of its Part VII tax liability on the last day of the second month following the end of the year. The treatment of this amount as a tax instalment effectively ensures its recovery by taxpayers.

ITA 192(6)

New subsection 192(6) defines the term "qualifying share". A qualifying share is defined as a share of a taxable Canadian corporation that is issued after June 30, 1983 and before 1987 and which meets certain qualifications. These qualifications are generally intended to ensure that the share carries no significant preferences over common stock and that the share was issued as consideration for a new infusion of capital that will remain in the corporation for a reasonable period of time. As a general rule, all new issues of common stock will qualify.

A share issued by a corporation for consideration that includes another share of the capital stock of the same corporation will not be a qualifying share, nor will a flow-through share issued under circumstances referred to in section 66.3 of the Act. Since the cost of flow-through shares is fully deductible, the share-purchase tax credit will not be available on the purchase of such shares.

A share will not be a qualifying share if the dividend entitlement and the liquidation entitlement thereon are limited by way of a formula or otherwise to a maximum amount. For example, a preferred share generally carries a fixed dividend and will not be a qualifying share. However, some shares may carry a relatively small fixed dividend rate while all or substantially all of their yield is based on their participation in the earnings of the corporation along with other shares. Subsection 192(7) provides exceptions to the general rules to ensure that such shares are treated as qualifying shares.

A qualifying share may not be subject to a right or obligation, absolute or contingent, on the part of the issuing corporation or certain other persons at any time to redeem, acquire or cancel the share or convert it into another security except for an amount that approximates its fair market value at that time—determined without regard to the value of the right or obligation. In addition, a share will not qualify if the issuing corporation is required to reduce its paid-up capital.

As well, a share of a corporation will not qualify if the corporation or certain other persons can reasonably be expected to reduce its paid-up capital or, within two years from the date of its issue, redeem, acquire or cancel the share or convert it into another security (unless that security would itself be a qualifying share). New paragraph 192(6)(d) also authorizes the issuance of regulations to extend the definition of a qualifying share.

ITA 192(7)

New subsection 192(7) provides that, for the purposes of the definition "qualifying share", neither the dividend entitlement nor the liquidation entitlement of a share of a corporation will be treated as limited to a maximum amount if it is reasonable to consider that substantially all of the entitlement is determinable by reference to the entitlement of another qualifying share of the corporation.

Subsection 192(7) further provides that a share issued as a result of a merger or amalgamation will be considered to be the same as the original share and that the resulting new corporation will be considered to be the same corporation as its predecessor corporations.

ITA 192(8)

New subsection 192(8) permits a corporation to designate an amount in respect of a share for the purpose of the share-purchase tax credit even though the designation has not been made within the time period specified in subsection 192(4). A late designation may be made if the corporation has made the prescribed information return in respect of the share within the required time limit and has paid to the Receiver General a reasonable estimate of the penalty for filing a late designation. A late designation cannot be more than three years late and in any event must be made within 90 days after notification by the Minister of National Revenue that the required designation was not made.

ITA 192(9)

New subsection 192(9) determines the amount of the penalty which must be paid under new subsection 192(8) in order to file a late designation in respect of a share. The penalty is normally equal to 1 per cent of the amount designated in respect of the share for each month or part thereof in the period beginning on the last day of the month following the month in which the share was issued and ending on the day the late designation is made. Under subsection 192(4) the commencement of this period is postponed to the day that is 90 days after the implementing legislation is enacted. The maximum penalty in respect of all shares issued in a month is $500.

ITA 192(10)

New subsection 192(10) provides that the amount of a corporation's investment tax credit that is used to generate a Part VII refund will be considered to have been deducted by the corporation from its Part I tax as investment tax credit claimed under subsection 127(5). The purpose of this provision is to ensure that the cost of the property or the amount of the expenditure that earned the investment tax credit will be reduced to the extent that the credit is utilized to generate a Part VII refund, in the same manner that the cost base of the property or expenditure will be reduced where subsection 13(7.1), paragraphs 53(2)(k) and 37(1)(e) of the Act normally apply as a consequence of the taxpayer claiming the investment tax credit against his Part I tax liability.

ITA 192(11)

New subsection 192(11) prevents a corporation from designating more than one amount in respect of the same share.

ITA 193(1)

New subsection 193(1) requires a corporation liable for Part VII tax to file a return under that Part by the date on which it is required to file its annual corporate tax return under Part I of the Act. For corporations, a return is required to be filed within six months from the end of its taxation year.

ITA 193(2)

New subsection 193(2) requires a corporation, which has designated an amount under new subsection 192(4) in respect of a share issued by it, to pay that amount—that is, its liability for the Part VII tax—by the end of the month following the month in which the share is issued. The tax equals the amount of share-purchase tax credit that flows out on the issue of the share.

ITA 193(3) and (4)

New subsection 193(3) provides that corporations which do not pay their Part VII tax on a timely basis as required under subsection 193(2) must pay interest from the date on which payment should have been made. However, subsection 193(4) provides that, in determining the interest which must be paid, the amount of Part VII tax payable is reduced by any Part VII refund to which the corporation is entitled for the year. This refund, as defined in new subsection 192(2), generally consists of the corporation's unclaimed share-purchase tax credits and post-April 19, 1983 investment tax credits as at the end of the year. Thus the investment tax credit that enters into a corporation's Part VII refund for a year may be used to reduce the amount of Part VII tax for the year on which interest is charged. In determining the tax liability at the end of a month on which interest is calculated, the amount of the corporation's Part VII tax for the year minus its Part VII refund for the year is multiplied by a fraction that has as its numerator the total of the amounts designated in respect of shares issued in the preceding month and as its denominator the total of the amounts designated in respect of all shares issued in the year. In effect, therefore, a corporation may use its investment tax credits and share-purchase tax credits earned in a year to reduce its liability for the ordinary corporate tax for the year or a preceding year, to offset its liability for the Part VII tax for the year or to obtain a refund of its Part VII tax paid in previous years.

ITA 193(5)

New subsection 193(5) denies a share-purchase tax credit to a shareholder in circumstances where he acquired shares when he knew or ought to have known that the issuing corporation would evade or attempt to evade payment of its Part VII tax liability.

ITA 193(6)

New subsection 193(6) is an anti-avoidance provision designed to preclude a corporation from avoiding interest on Part VII tax through the acquisition of shares of a corporation that it controls. Where it is reasonable to consider that one of the main purposes for the acquisition of a share was to avoid the payment of interest on Part VII tax for a period, the share shall be deemed not to have been acquired or issued until after the end of the period for the purposes of calculating the corporation's share-purchase tax credit and its Part VII refund.

For example, A Co. has a December 31 year-end and owes Part VII tax. On December 31, it buys shares of a subsidiary with a November 30 year-end for the express purpose of generating sufficient share-purchase tax credits to offset its Part VII tax liability. Subsection 193(6) is designed to counter this method of tax avoidance that could otherwise be used to defer the Part VII tax indefinitely. Subsection 193(6) will not generally apply where shares are acquired in order to "flow out" the investment tax credit of a subsidiary to its parent or the shareholders of the parent.

ITA 193(7)

New subsection 193(7) provides that where, in order to avoid liability for corporate distributions tax under Part II of the Act, a corporation designates an amount in respect of a share under subsection 192(4), the corporation is liable for a tax of 125 per cent of the Part II tax avoided.

The operation of this provision may be illustrated by way of an example. Assume that a corporation has a preferred-earnings amount for the purposes of Part II equal to its retained earnings of $100,000. If a shareholder subscribes for $400,000 of shares of the corporation and the corporation designates an amount of $100,000 under subsection 192(4), the shareholder will obtain a share-purchase tax credit of $100,000 against his tax payable under Part I, while the corporation will be liable for $100,000 of Part VII tax. In effect, the share-purchase tax credit mechanism operates in this case to distribute $100,000 from the corporation to the shareholder. Absent new subsection 193(7), this would result in a distribution of the corporation's preferred-earnings amount free of the corporate distributions tax. Subsection 193(7) which is intended to prevent this form of tax avoidance will generally not apply where shares were issued in order to "flow out" otherwise non-deductible investment tax credits or share-purchase tax credits to shareholders.

ITA 193(8)

New subsection 193(8) sets out the rules relating to the payment of tax and various other procedural and administrative matters with respect to the Part VII tax.

Refundable Tax on Corporation in Respect of Scientific Research Tax Credit Part VIII

New Part VIII of the Act is an integral part of the new financing mechanism described in the commentary on new section 127.3 of the Act. Part VIII, consisting of sections 194 and 195, provides for a refundable tax payable annually by a corporation in an amount equal to the scientific research tax credit that it makes available to investors through the issue of its shares, debt obligations or rights after September, 1983. However, the Part VIII tax liability of a corporation may be satisfied by renouncing the benefit of the deduction and investment tax credit in respect of scientific research expenditures made by it in the year or the immediately preceding year. For each $2 of such expenditures renounced, $1 of the Part VIII tax liability is eliminated. In addition, the corporation may offset its Part VIII tax liability by any scientific research tax credit it earns through investments it has made in other corporations. The corporation is required to pay the remaining Part VIII tax liability but the amount so paid is refundable in subsequent taxation years when scientific research expenditures are made or scientific research tax credits are earned. This mechanism enables a corporation to issue shares or debt obligations, or grant rights, that carry rights to the scientific research tax credit even though it has not at the time of issue made the necessary qualifying expenditures.

ITA 194(1)

New subsection 194(1) of the Act imposes the Part VIII tax liability on a corporation that has issued shares or debt obligations, or granted rights, entitling the purchaser to scientific research tax credit. The corporation's liability for the Part VIII tax in a year is equal to 50% of all amounts designated by it under new subsection 194(4) in respect of such shares, debt obligations or rights issued or granted by it in the year.

ITA 194(2)

New subsection 194(2) of the Act defines the "Part VIII refund". This refund is the lesser of two amounts:

The first amount is the sum of:

— the corporation's scientific research tax credit for the year that was not deducted from its Part I tax, and

— such amount as a corporation chooses to claim, not exceeding 50% of its scientific research expenditures made by it after April 19, 1983 and in the year or the preceding year, provided the expenditures did not give rise to a Part VIII refund for the preceding year, a deduction under section 37 or 37.1 of the Act or an investment tax credit claim.

The second amount is the corporation's "refundable Part VIII tax on hand" at the end of the year as defined in new subsection 194(3).

ITA 194(3)

New subsection 194(3) of the Act defines a corporation's "refundable Part VIII tax on hand" at the end of a taxation year. This amount represents the maximum refund of the Part VIII tax to which a corporation is entitled in a year. It consists of the total of the Part VIII taxes payable by the corporation in the year and in all preceding years minus the total of its Part VIII refunds for all preceding years.

Example:

— Corporation issues shares and designates $1,000 in respect of the shares.

— Part VIII tax liability under subsection 194(1): 50% of $1,000=$500.

— Corporation spends $800 on scientific research expenditures which it renounces under subsection 194(2).

— Part VIII refund under 194(2): 50% of $800=$400.

— If corporation has paid the $500 Part VIII tax as required by subsection 195(2), it will get a refund of $400.

— Under subsection 194(3) the corporation's refundable Part VIII tax on hand at the end of the following year is $500 minus $400=$100.

ITA 194(4)

A corporation that wishes to designate scientific research tax credits on the issue of a share or debt obligation, or on the grant of a right, is required under new subsection 194(4) of the Act to designate an amount in respect thereof. The amount so designated cannot exceed the amount of the consideration for which the corporation issued the share or debt obligation or granted the right. Where the purchaser of a share is entitled to receive an amount from a government, municipality or other public authority in respect of his purchase of the share, the consideration for which it was issued shall, for this purpose, be reduced by that amount. The corporation must make the designation by filing certain prescribed information before the end of the month following the month in which the share or debt obligation is issued, or the right is granted, or within 90 days following Royal Assent to the Bill. A corporation cannot, in respect of a share it issues, make designations under both this subsection and subsection 192(4) of the Act dealing with the share-purchase tax credit.

ITA 194(5)

New subsection 194(5) of the Act provides that a corporation's Part VIII refund for a taxation year will be considered to have been paid as an amount on account of its Part VIII tax liability for the year on the last day of the second month following the end of the year. This treatment effectively ensures the recovery of Part VIII tax actually paid by the corporation.

ITA 194(6)

New subsection 194(6) defines the term "scientific research financing contract" for the purposes of the scientific research tax credit and the Part VIII refundable tax. A scientific research financing contract is essentially a written contract between an investor and a corporation under which the investor is granted a right under the contract to receive a royalty or similar payment.

ITA 194(7)

New subsection 194(7) of the act permits a corporation to designate an amount in respect of a share, debt obligation or right for the purposes of the scientific research tax credit even though the designation has not been made within the time period specified in subsection 194(4). A late designation may be made if the corporation has made the prescribed information return in respect of the share, debt obligation or right as and when required and has paid to the Receiver General a reasonable estimate of the penalty for filing a late designation. A late designation cannot be more than three years late and in any event must be made within 90 days after notification by the Minister of National Revenue that the required designation was not made.

ITA 194(8)

New subsection 194(8) of the Act determines the amount of the penalty which must be paid under subsection 194(7) in respect of a late designation. The penalty is normally equal to 1% of the amount designated in respect of the share, debt obligation or right for each month or part thereof in the period beginning on the last of the month following the month in which the share or debt obligation was issued or the right was granted, and ending on the day the late designation is made. Under subsection 194(4) this period will not commence until 90 days after Royal Assent to the Bill. The maximum penalty for a month is $500.

ITA 194(9)

New subsection 194(9) prevents a corporation from designating more than one amount in respect of the same share, debt obligation or right.

ITA 195(1)

New subsection 195(1) of the Act requires a corporation liable for Part VIII tax to file a return under that Part by the date on which it is required to file its annual corporate tax return under Part I of the Act. For corporations, a return is required to be filed within six months from the end of its taxation year.

ITA 195(2)

New subsection 195(2) requires a corporation which has designated an amount under new subsection 194(4) in respect of shares or debt obligations issued by it or rights granted by it to pay 50% of that amount—i.e., its liability for the Part VIII tax—by the end of the month following the month in which the shares or debt obligations were issued or the rights were granted. The tax equals the amount of the scientific research tax credit that an investor will earn in respect of those shares, debt obligations or rights.

ITA 195(3) and (4)

New subsection 195(3) provides that corporations which do not pay their Part VIII tax by the date required under subsection 195(2) must pay interest from that date. However, new subsection 195(4) provides that, in determining the interest payable, the amount of Part VIII tax payable is reduced by any Part VIII refund to which the corporation is entitled for the year. In determining the month-end tax liability on which interest is calculated, the amount of the corporation's Part VIII tax for the year minus its Part VIII refund for the year is multiplied by a fraction that has as its numerator the total of the amounts designated by it in respect of all shares and debt obligations issued, and rights granted, in the preceding month and as its denominator the total of the amounts designated by it in respect of all shares and debt obligations issued, and rights granted, in the year.

Example:

— Corporation designates $200 in February in respect of shares issued in January and does not pay tax.

— Total designated by corporation in respect of all shares issued in the year $1,000.

— Part VIII tax liability for the year: 50% of $1,000=$500.

— Part VIII refund (assumed) $350.

— Net Part VIII tax payable $150.

— Interest will be computed from end of February on unpaid tax of $30, arrived at as follows:

$$\$150 \times \frac{\$200}{\$1,000} = \$30.$$

ITA 195(5)

New subsection 195(5) is an anti-avoidance provision. It denies the scientific research tax credit to a purchaser of a share, debt obligation or right in circumstances where he knew or ought to have known that the corporation issuing the share or debt obligation or granting the right would evade or attempt to evade payment of its Part VIII tax liability.

ITA 195(6)

New subsection 195(6) is an anti-avoidance provision designed to preclude a corporation from avoiding interest on Part VIII tax through the acquisition of shares, debt obligations or rights issued or granted by a corporation that it controls. Where it is reasonable to consider that one of the main purposes for acquiring a share, debt obligation or right was to avoid the payment of interest on Part VIII tax for a period, the share, debt obligation or right shall be deemed not to have been acquired or issued or granted until after the end of the period for the purposes of calculating the corporation's scientific research tax credit and its Part VIII refund.

For example, a company with a December 31 year-end owes Part VIII tax and late in the year it acquires a share of a subsidiary with a November 30 year-end for the purpose of generating sufficient scientific research tax credits to offset its Part VIII tax liability. In the absence of new subsection 195(6), the liability for the Part VIII tax would be transferred to the subsidiary and postponed for 11 months. Indeed, the subsidiary could in turn acquire shares of a sub-subsidiary and by this means the corporate group could effectively postpone the tax indefinitely.

ITA 195(7)

New subsection 195(7) provides that where, in order to avoid liability for corporate distributions tax under Part II of the Act, a corporation designates an amount in respect of a share, debt obligation or a right under subsection 194(4), the corporation is liable for a tax of 125 per cent of the Part II tax avoided.

The operation of this new subsection may be outlined by way of an example. Assume that a corporation has a preferred-earnings amount for the purposes of Part II equal to its retained earnings of $100,000. If a shareholder subscribes for $400,000 of shares of the corporation and the corporation designates an amount of $200,000 under subsection 194(4), the shareholder will obtain a scientific research tax credit of approximately $100,000 while the corporation will become liable for $100,000 of Part VIII tax. In effect, the scientific research tax credit mechanism operates in this case to distribute $100,000 from the corporation to the shareholder. Absent new subsection 195(7), this would result in a distribution of the corporation's preferred-earnings amount free of the corporate distributions tax. Subsection 195(7) which is intended to prevent this form of tax avoidance will generally not apply where shares were issued in order to "flow out" otherwise non-deductible scientific research tax credit or scientific research expenditures.

ITA 195(8)

New subsection 195(8) sets out the rules relating to the payment of tax and various other procedural and administrative matters with respect to the Part VIII tax.

Subclauses 96(2) and (3)

This sets out the effective date for the new Parts VII and VIII dealing with the refundable tax on corporations in respect of share-purchase and scientific research tax credits.

Interest on Overpayments of Part X Tax
ITA
202(4)

Clause 97

Existing subsection 202(4) of the Act ensures that the rules contained in subsections 164(3) and (4) with respect to interest on overpayments of tax under Part I are applicable to overpayments of the special tax imposed under Part X with respect to non-qualified investments of deferred profit sharing plans. Subsection 202(4) is amended, with respect to interest paid or applied after April 19, 1983, to make the rules in new subsection 164(3.1) of the Act applicable for the purposes of the Part X tax.

Property of Deferred Income Plans
ITA
206(2)(e.1)

Clause 98

Subsection 206(2) of the Act defines the term "foreign property" for the purpose of the tax imposed under subsection 206(1). Paragraph 206(2)(e.1) includes in this definition property that is convertible to or exchangeable for foreign property. The amendment to this paragraph ensures that shares of a public corporation that are issued before 1984 and are listed on a Canadian stock exchange will not be considered foreign property even if they are convertible to or exchangeable for foreign property. The amendments also extend to warrants issued before 1984 and to listed shares issued on the exercise of such warrants.

Non-Resident Withholding Tax

Clause 99

Section 212 is the principal provision of the Act dealing with the non-resident withholding tax. It enumerates the various payments to non-residents that are subject to this tax.

Subclause 99(1)

ITA 212(1)(f)

The amendment to paragraph 212(1)(f) is consequential on certain amendments made in Bill C-139 which extended the rules for the deduction and taxation of qualifying maintenance allowances so that they apply to common-law spouses recognized by provincial law as qualifying for support obligations. The payor of the maintenance allowance is entitled to a deduction for the amount paid and the recipient must bring the receipt into income. This amendment ensures that the non-resident withholding tax, which applies where the recipient is the spouse or former spouse of the person making the payment, will also apply to maintenance payments to common-law spouses not resident in Canada where the payment is deductible. This amendment will come into force upon Royal Assent to the Bill.

Subclauses 99(2) and (3)

ITA 212(11.1)(a) and (11.2)

Subsections 212(11.1) and (11.2) of the Act provide an exception from the non-resident withholding tax for certain distributions to beneficiaries by a trust which were not deductible by the trust in computing its income but which were subject to tax under Part I of the Act in the hands of the trust. The amendments to these subsections are consequential to the amendments to subsection 104(8) of the Act and are applicable after November 12, 1981.

Subclause 99(4)

This sets out the effective date for the amendments to subsections 212(11.1) and (11.2) of the Act.

Penalties and Assessment
ITA
227(10)

Clause 100

Subsection 227(10) of the Act permits the Minister of National Revenue to assess a person for a penalty payable under section 234.1 with respect to the failure to file a prescribed fuel certificate relating to aviation turbine fuel used on international flights. Section 234.1 is repealed and the amendment to subsection 227(10) deletes the reference to it. The amendment is effective with respect to purchases of aviation turbine fuel after April 30, 1983.

Liability of Directors

Clause 101

ITA 227.1

Section 227.1 of the Act relates to the liability of the directors of a corporation for the withholding tax obligations imposed on the corporation under sections 135, 153 and 215 of the Act. The liability is imposed on persons who were directors at the time the corporation failed to deduct or withhold or remit the required tax. The liability also extends to any related interest or penalty. This amendment to subsection 227.1(1) extends the liability where a corporation has failed to pay its Part VII tax liability (related to the new share-purchase tax credit) or its Part VIII tax liability (related to the new scientific research tax credit) for a taxation year. This amendment is applicable to the 1983 and subsequent taxation years.

Books and Records

ITA
230(1.1)

Clause 102

Section 230 of the Act requires that taxpayers and other specified parties maintain adequate books and records to enable the Minister of National Revenue to determine the taxes payable under the Act or amounts that should have been deducted, withheld or collected under the Act. New subsection 230(1.1) requires the administrator of an indexed security investment plan to maintain adequate books and records to enable the Minister to verify a taxpayer's taxable capital gain or allowable capital loss from the plan.

Aviation Turbine Fuel

Clause 103

ITA
234.1

Section 234.1 of the Act requires an air carrier resident in Canada who purchases aviation fuel and uses it on an international flight to complete and deliver a fuel certificate specifying the amount of fuel used on an international flight, and imposes a penalty on an air carrier who fails to do so. This clause repeals section 234.1 effective with respect to purchases of aviation turbine fuel after April 30, 1983.

Mailing Date

ITA
244(14)

Clause 104

Subsection 244(14) of the Act provides that the day of mailing of a notice of assessment or other notification shall, in the absence of any evidence to the contrary, be the date appearing thereon. This subsection is amended to add a reference to new subsections 192(8) and 194(7) which provide that a corporation has 90 days to respond to a notice by the Minister of National Revenue that it has not filed a designation as required. This amendment applies to the 1983 and subsequent taxation years.

Definitions

Clause 105

ITA 248(1)

Section 248 of the Act defines many of the terms used in the Act.

Subclause 105(1)

"Cost Amount"

This addition to the definition of "cost amount" is consequential on new section 47.1 and provides that the cost amount of property held under an indexed security investment plan is its fair market value. This is relevant where subsection 107(2) is applicable as a consequence of the distribution by a trust of an indexed security.

Subclause 105(2)

"Farm Loss"

The addition of the definition "farm loss" is consequential on the introduction of the new rules relating to farm loss carryovers in section 111 of the Act. This amendment ensures that the definition as set out in subsection 111(8) applies wherever the expression "farm loss" is used in the Act.

Subclause 105(3)

"Indexed Security"

This subclause provides that the expression "indexed security" has the meaning assigned by new paragraph 47.1(1)(e) of the Act relating to indexed security investment plans.

Subclause 105(4)

"Indexed Security Investment Plan"

This subclause provides that the expression "indexed security investment plan" has the meaning assigned by new paragraph 47.1(1)(f) of the Act.

Subclause 105(5)

"lawyer"

The addition of the definition "lawyer" results in Quebec notaries being treated as lawyers for all purposes of the Act. This ensures that they will be entitled to exclude work in progress at the end of the year in the calculation of their professional income.

Subclause 105(6)

"Participant"

This subclause provides that the expression "participant" under an indexed security investment plan has the meaning assigned by new paragraph 47.1(1)(h) of the Act.

Subclauses 105(7) and (8)

This sets out the effective date for the amendments to section 248 of the Act.

Relationship

ITA
251(6)

Clause 106

Subsection 251(6) defines the circumstances in which persons are considered to be connected by blood relationship, marriage or adoption. The amendment to this subsection corrects a cross-reference to subparagraph 109(1)(b)(ii), the deduction for wholly dependent persons, as amended by Bill C-139.

Acquisition of Control

Clause 107

ITA
256(8)(a)

Subsection 256(8) of the Act is an anti-avoidance provision. It applies where a taxpayer has an option to acquire shares of a corporation or to control the voting rights of shares and one of the main purposes in acquiring the option was to avoid the limitations on the deduction of net capital or non-capital losses under section 111 or on the deduction of exploration and development expenses under section 66 or to avoid the application of subsection 111(5.1) or (5.2) where there has been a change of control of the corporation. In these circumstances the taxpayer is deemed to have acquired the shares to which the option relates.

Paragraph 256(8)(a) of the Act is amended, effective for the 1983 and subsequent taxation years, to add a reference to "farm loss". This amendment is consequential on the introduction of the new provisions relating to farm loss carryovers in section 111 of the Act.

Adjustment to Cost Base of Interest in Partnership

Clause 108

Subsection 26(9.4) of the Income Tax Application Rules, 1971 provides rules for the purpose of computing a taxpayer's adjusted cost base of a partnership interest where he was a member of the partnership on December 31, 1971 and throughout the subsequent period ending at the particular time the adjusted cost base is to be calculated.

ITAR, 1971 26(9.4)(b)

Paragraph 26(9.4)(b) is amended to delete the reference to paragraph 69(7.1)(b) of the Income Tax Act as a consequence of the repeal of the provisions in subsection 69(7.1) of the Act relating to the sale of aviation turbine fuel used on international flights. This paragraph is also amended to add a reference to paragraphs 81(1)(r) and (s) of the Act as a consequence of the addition of those paragraphs to the Act. The deletion of the reference to paragraph 69(7.1)(b) is effective after Royal Assent to the Bill and the addition of the references to paragraphs 81(1)(r) and (s) is effective for the 1982 and subsequent taxation years.

Successor Rules

ITAR,
1971
29(25) and (29)

Clause 109

Subsections 29(25) and (29) of the Income Tax Application Rules, 1971 provide successor rules that allow exploration or development expenses incurred by a corporation before 1972 and not deductible by it to continue to be deducted by a "successor" corporation which acquires all or substantially all the assets used by the first corporation in its resource business. The expenses may similarly be passed on from the successor corporation to a second successor corporation. The expenses that are passed on to a successor corporation or second successor corporation may be deducted only against resource income from assets acquired from the first corporation.

The amendments to these provisions expand the existing successor rules by dropping the requirement that the transferor be a corporation. As a result, the successor rules will now also be available in the case where an individual or other person transfers all or substantially all of his resource assets to a corporation.

The amendments are applicable with respect to acquisitions of property by a successor corporation from a predecessor after April 19, 1983.

Deductions Prohibited – Business and Property Income
ITA
18(1)(m)(v)

Clause 110

This clause changes the effective date of application of the amendment to subparagraph 18(1)(m)(v) of the Income Tax Act that was contained in Bill C-139 dealing with the non-deductibility of Crown resource taxes and royalties. Under Bill C-139, the amendment was applicable for taxation years commencing after 1982. Under this clause, the amendment to subparagraph 18(1)(m)(v) is made applicable in respect of amounts paid or that became payable after December 31, 1982 in respect of the period after that date.

Gain on the Settlement of a Debt Obligation

ITA
80(3)

Clause 111

Where a debt is settled or extinguished for less than its principal amount, subsection 80(1) of the Act applies to reduce the debtor's loss carryovers and the tax cost of his capital property. Subsection 80(3), introduced in 1983 with respect to windings-up occurring after November 12, 1981, permits a parent corporation in certain circumstances to elect to treat a debt of its subsidiary settled or extinguished on winding-up as having been settled for its tax cost. This election is required to be filed within six months of the end of the taxation year in which the debt was settled. This amendment to subsection 43(5) of Bill C-139 extends the time for filing the election to the end of 1983.

Employee and Shareholder Loans
ITA
80.4

Clause 112

Subsection 80.4(1) of the Act deals with employee loans. It provides that where any person received a non-interest bearing or low interest loan by virtue of an individual's employment or by virtue of the performance of services by a corporation that carries on a personal services business, the individual or corporation will be treated as having received a taxable benefit. Subsection 80.4(2) provides similar rules for shareholder loans. This clause deals with the coming-into-force rules for these provisions.

Under the June 28, 1982 draft legislation, subsection 80.4(2) did not apply to debt between corporations that dealt with each other at arm's length. However, under Bill C-139, the exclusion for inter-company loans was restricted to loans made to corporations resident in Canada. This clause provides a transitional rule in respect of non-arm's length loans to non-resident corporations so that subsection 80.4(2) only applies for the period after June 1983 in respect of any such loan made on or before December 7, 1982, the date on which Bill C-139 was tabled.

Another amendment in this clause ensures that section 80.4, as amended by Bill C-139, applies only with respect to the measurement of interest benefits after December 31, 1981.

Under Bill C-139, these new provisions were made applicable to taxation years ending after 1981. The amendment ensures that no benefit under the new rules will be attributed to the portion of a person's 1982 taxation year that falls within 1981.

Deemed Interest Expense
ITA
80.5

Clause 113

Under section 80.4 of the Act, where an employee directs his employer to make a loan to a related person, the employee may be treated as having received a benefit from his employment. However, under section 80.5, only the debtor is allowed to treat the amount of the benefit as an interest expense.

This clause provides a transitional amendment to address those cases where the employee is not the debtor. It enables the employee who has a benefit included in his income under section 80.4 to obtain a deduction that would under section 80.5 (and paragraph 20(1)(c)) otherwise be available only to the debtor. The deduction is available to the employee only where the debtor does not claim the interest expense. This rule applies only to the 1982 taxation year to address the concern of those employees who were unable in that year to rearrange their affairs in light of the changes to the provisions of the Act relating to employee loans.

Deferred Income Plans

ITA
146(1)(c.1)
146(2)(c.4)
146.2(2)(h.1)
146.3(2)(f.1)
147(2)(k.1)

Clauses 114 to 117

These clauses of the Bill change the effective dates of application of the amendments to the provisions of the Income Tax Act that were contained in Bill C-139 relating to deferred income plans—registered retirement savings plans, registered home ownership savings plans, registered retirement income funds and deferred profit sharing plans. These amendments require every deferred income plan registered after November 12, 1981 to contain a prohibition against certain kinds of ancillary or supplementary benefits other than those provided for under the plan itself. Clauses 114 through 117 change the effective date of this requirement from November 12, 1981 to April 1, 1983 so that plans registered before April 1, 1983 need not be revised. Although no plans registered after November 12, 1981 may provide such benefits, only new plans issued after March 1983 are required to contain an express prohibition against such benefits.

General Definitions

Clause 118

CPP
2(1)

The definition "prescribed" is amended, upon Royal Assent to the Bill, to provide authority to set out in the Canada Pension Plan Regulations either a rate of interest or the formula by which the prescribed rate is determined. A similar amendment to the definition "prescribed" in the Income Tax Act was made by Bill C-139. The rate of interest used in the Canada Pension Plan Regulations is the same as that used in the Income Tax Regulations. The amendment ensures that the definition "prescribed" is consistent with that contained in the Income Tax Act.

Deductions by Employer
CPP
22(1)

Clause 119

Subsection 22(1) imposes an obligation upon an employer paying remuneration to an employee to deduct an amount in respect of the employee's contribution to the Canada Pension Plan and remit such amount to the Receiver General. The amendment removes the necessity to annually amend the Canada Pension Plan Regulations to set out the prescribed amount by instead prescribing rules by which this amount can be determined. This is an approach similar to that of subsection 117(6) of the Income Tax Act.

CPP
22(4)

This amendment is strictly consequential on the amendment to subsection 22(1).

These amendments to section 22 of the Canada Pension Plan are applicable after December 31, 1984.

Liability of Directors

Clause 120

CPP
22.1

New section 22.1 imposes liability on the directors of an employer corporation that fails to deduct or remit an amount in respect of employee contributions to the Canada Pension Plan. This amendment parallels the corresponding provision contained in section 227.1 of the Income Tax Act and is effective upon Royal Assent to the Bill.

Application of Income Tax Act
CPP
24(2)

Clause 121

This amendment, effective upon Royal Assent, relates to collection procedures and is consequential on the addition of sections 224.2 and 224.3 to the Income Tax Act by Bill C-139.

Effective Date

Clause 122

This provides the coming-into-force date for the amendments to section 22 relating to employer deductions of Canada Pension Plan contributions.

General Definitions

Clause 123

UIA
2(1)(u)

The definition "prescribed" is amended, upon Royal Assent to the Bill, to provide authority to set out in the Unemployment Insurance Regulations either a rate of interest or the formula by which the prescribed rate is determined. A similar amendment to the definition "prescribed" in the Income Tax Act was made by Bill C-139. The rate of interest used in the Unemployment Insurance Regulations is the same as that used in the Income Tax Regulations. The amendment ensures that the definition "prescribed" is consistent with that contained in the Income Tax Act.

Liability of Directors

Clause 124

UIA
68.1

New section 68.1 imposes liability on the directors of an employer corporation that fails to deduct or remit an amount in respect of employee unemployment insurance premiums. This amendment parallels the corresponding provision contained in section 227.1 of the Income Tax Act and is effective upon Royal Assent to the Bill.

Application of Income Tax Act
UIA
80

Clause 125

This amendment, effective upon Royal Assent, relates to collection procedures and is consequential on the addition of sections 224.2 and 224.3 to the Income Tax Act by Bill C-139.