Technical Notes to a Notice of Ways and Means Motion Relating to Income Tax

Issued by
The Honourable Michael Wilson
Minister of Finance

June 3, 1987

Canada

ERRATUM

Any reference in these technical notes to June 3, 1987 shall be read as a reference to June 5, 1987, the date of the tabling of the Notice of Ways and Means Motion to amend the Income Tax Act, a related Act, the Canada Pension Plan and the Unemployment Insurance Act, 1971.

ERRATUM

Dans les présentes notes techniques, la date du 3 juin 1987 est remplacée par celle du 5 juin 1987, date du dépôt de l'Avis de motion des voies et moyens visant à modifier la Loi de l'impôt sur le revenu et la législation connexe ainsi que le Régime de pensions du Canada et la Loi de 1971 sur l'assurance-chômage.

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Department of Finance Canada
Ministère des Finances Canada

These technical notes are provided to assist in an understanding of the amendments proposed to be made to the *Income Tax Act*, the *Income Tax Application Rules, 1971*, the *Canada Pension Plan* and the *Unemployment Insurance Act, 1971*. They are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

Cette publication est également offerte en français.

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Preface

The Notice of Ways and Means Motion contains proposed amendments to the *Income Tax Act*, the *Income Tax Application Rules, 1971*, the *Canada Pension Plan* and the *Unemployment Insurance Act, 1971* that were announced in the February 18, 1987 budget. The Notice also contains previously announced income tax amendments relating to collateralized preferred shares, tax avoidance on corporate distributions, international banking centres, retirement compensation arrangements and the acquisition of gains and losses.

These technical notes explain the proposed amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisers. In addition, several draft regulations relating to the proposed amendments are attached as appendices.

The Honourable Michael Wilson
Minister of Finance

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Income from an Office or Employment

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ITA 6

Section 6 of the Act deals with amounts to be included as income from an office or employment.

Subclause 1(1)

ITA 6(1)(a)(ii)

Paragraph 6(1)(a) of the Act generally requires employment-related benefits received or enjoyed by an employee, other than those benefits specifically excluded, to be included in computing his employment income. This paragraph is amended, applicable after October 8, 1986, to exclude benefits received under a retirement compensation arrangement. These benefits are included in computing a taxpayer's income under section 56 as income from other sources, in the same way as pension and retirement benefits. Reference may be made to the commentary under that provision.

Subclause 1(2)

ITA 6(15)

New subsection 6(15) of the Act clarifies that, for the purposes of paragraph 6(1)(a), the value of the employment-related benefit arising on the forgiveness of a loan or other obligation is the amount of the obligation that was forgiven. Thus, for example, if an employee owes his employer $5,000 and settles the loan by paying $1,000, he will be required to include $4,000 in his income as a benefit related to his employment. This new subsection applies to obligations forgiven after February 17, 1987.

Employee Stock Options

Clause 2

ITA 7(1.4)

Section 7 of the Act sets out the rules for determining the benefit derived by a taxpayer from an employment-related stock option. Subsection 7(1) requires an income inclusion where an employee disposes of his rights under such an option. Subsection 7(1.4) provides an exception to this rule where the disposition occurred as the result of the merger or amalgamation of the corporation which granted the original option and the employee received an option to acquire shares of the newly amalgamated corporation in exchange for his original option. Under these rules, the new option is treated as if it were the original option. A related provision, paragraph 110(1)(d) of the Act, provides a deduction in computing taxable income where certain stock options are exercised. Subsection 7(1.4) is amended to ensure that the rules relating to an amalgamation apply also for the purposes of paragraph 110(1)(d). As a result of the amendment, a substituted option received from an amalgamated corporation in exchange for an original option granted by a predecessor corporation will not lose eligibility for the paragraph 110(1)(d) deduction because of the substitution. This amendment is applicable with respect to options acquired on an amalgamation or merger occurring after 1984, which coincides with the introduction of subsection 7(1.4).

Clause 3

ITA
12

Section 12 of the Act requires the inclusion of specified items in computing a taxpayer's income from a business or property.

Subclause 3(1)

ITA
12(1)(m)

Paragraph 12(1)(m) of the Act requires a taxpayer's income from a trust or estate to be included in computing income from a business or property. The amendment to that paragraph is consequential on the introduction of the special rules relating to retirement compensation arrangements (RCAs). The effect of the change is to exclude from the scope of this paragraph income from an "RCA trust", as that expression is defined in new subsection 207.5(1). Benefits received from an "RCA trust" are included in income under other provisions of the Act. In the case of a contributing employer, the inclusion for a refund of contributions is provided under new paragraph 12(1)(n.3) and, in the case of employees or other beneficiaries, benefits received from an "RCA trust" are included under new paragraphs 56(1)(x) and (z).

Subclause 3(2)

ITA
12(1)(n.3)

New paragraph 12(1)(n.3) of the Act, applicable after October 8, 1986, requires amounts received by an employer from certain retirement compensation arrangements to be included in the employer's income. Included for this purpose is any retirement compensation arrangement to which the taxpayer, a predecessor of the taxpayer or a non-arm's length person made contributions as an employer. Contributions made by a taxpayer as an employer to a retirement compensation arrangement on behalf of his employees or former employees are deductible under paragraph 20(1)(r) of the Act.

Subclause 3(3)

ITA
12(1)(v)

The amendment to paragraph 12(1)(v) of the Act is consequential on the changes to section 37 relating to the deduction of scientific research and experimental development expenditures. Under subsection 37(1), such expenditures are accumulated in a pool and the balance in that pool at the end of any year may either be deducted in that year or carried forward for deduction in later years. Where the balance in the pool is negative, the negative balance is required by paragraph 12(1)(v) to be included in the taxpayer's income, thereby restoring the pool to a nil balance. This paragraph is amended, applicable to taxation years ending after January 15, 1987, as a consequence of the introduction of new paragraph 37(1)(h), to ensure that a corporation's research and development expenditures made before a change of its control that are subject to a restriction on deduction after such change are taken into account in determining the negative balance to be included in income.

Subclause 3(4)

ITA
12(11)(b)

Paragraph 12(11)(b) of the Act defines the term "third anniversary" of an investment contract for the purposes of the interest accrual rules. These rules, which were introduced for taxation years commencing after 1981, require accrued interest on such contracts to be included in income at least every third year. For investment contracts acquired before 1982, the first three-year period is considered to commence on December 31, 1984, with the result that the first year in which accrued interest must be reported on such instruments is 1987. This provision is amended so that for investment contracts acquired before 1982, the first three-year period will be considered to have commenced on December 31, 1985. Accordingly, the first year in which accrued interest must be reported on such contracts is postponed for one year until 1988. This amendment is effective for the 1987 and subsequent taxation years.

Rules Relating to Depreciable Property

Clause 4

Section 13 of the Act provides various rules relating to the tax treatment of depreciable property.

Subclause 4(1)

ITA
13(7)(f)

Subsection 13(7) of the Act provides rules relating to capital cost that apply where there has been a change of use of depreciable property, where depreciable property is used partly for gaining or producing income and partly for some other purpose, and where depreciable property is transferred between persons not dealing at arm's length.

New paragraph 13(7)(f) of the Act applies where a corporation is treated by either paragraph 111(4)(e) or 149(10)(b) as having disposed of and reacquired depreciable property. Paragraph 111(4)(e) allows a corporation that has undergone a change of control to elect to treat certain capital property as having been disposed of in the taxation year ending immediately before the change of control. Such property is treated as having been reacquired by the corporation at the time of the change of control. Subsection 149(10), which applies where a corporation ceases to be exempt from tax under Part I of the Act on its taxable income, is amended to apply also where a corporation becomes exempt from tax on its taxable income. Where the taxable status of a corporation changes, its depreciable property is treated as having been disposed of immediately before the change for proceeds equal to its fair market value and as having been reacquired immediately thereafter.

Where new paragraph 13(7)(f) applies, the capital cost to the corporation of depreciable property at the time of the reacquisition is treated as being the aggregate of the capital cost to the corporation of the property at the time of the disposition and one-half of the excess of the proceeds of disposition of the property over such capital cost. This rule is similar to that in existing paragraph 13(7)(e) where depreciable property is acquired in a non-arm's length transaction. The amendment applies for the purposes of sections 13 and 20 of the Act and the capital cost allowance regulations but not for the purpose of determining the adjusted cost base of property for the purpose of the provisions relating to capital gains.

New paragraph 13(7)(f) is applicable where control of a corporation is acquired after January 15, 1987 and where a corporation after June 3, 1987 becomes or ceases to be exempt from tax under Part I of the Act.

Subclause 4(2)

ITA
13(24) and (25)

New subsection 13(24) of the Act adds a special rule that applies where a corporation or a partnership of which a corporation is a majority interest partner has acquired a depreciable property within the 12-month period ending immediately before a change of control of the corporation and the property was not used, or acquired for use, in a business carried on before that period. Under this special rule, the capital cost of property acquired in the 12-month period will not be included in computing undepreciated capital cost until after the change of control. Also, for the purposes of the investment tax credit and the refundable investment tax credit, the property will be considered not to have been acquired until after the change of control. Where the property was disposed of and not reacquired before the change of control, the property is treated for capital cost allowance purposes as having been acquired immediately before the disposition. The purpose of this special rule is to prevent the transfer of depreciable property in contemplation of a change of control in order to reduce taxable income where the persons acquiring control would not themselves be in a position to use the capital cost allowance or investment tax credit on the property.

This special rule does not apply where the property was owned by the corporation, the partnership or a person related to the corporation throughout the period commencing immediately before the 12-month period and ending when the property was acquired by the corporation or partnership. Where a corporation has been incorporated or otherwise formed during the 12-month period, it is treated by new subsection 13(25), for the purpose of this related-person exception, as having been in existence during the period commencing immediately before the 12-month period and ending immediately after it was incorporated or otherwise formed, and as having been related throughout that period to the person or persons to whom it was related (without reference to any right referred to in paragraph 251(5)(b) of the Act) throughout the period of its existence ending immediately before the change of control.

New subsections 13(24) and (25) are applicable with respect to acquisitions of property occurring after January 15, 1987 other than acquisitions of property occurring before 1988 where the persons acquiring the property were obliged on January 15, 1987 to acquire the property under agreements in writing entered into on or before that date.

Shareholder Loans

Clause 5

ITA
15(1.2)

Section 15 of the Act requires the inclusion in income of certain benefits received or enjoyed by shareholders of corporations. New subsection 15(1.2) clarifies that the value of the shareholder's benefit arising on the forgiveness of a loan or other obligation is the amount of the obligation that was forgiven and that was not previously included in the shareholder's income at the time the loan was made. This amendment corresponds to that proposed in subsection 6(15) relating to the forgiveness of employee loans. New subsection 15(1.2) applies to obligations forgiven after February 17, 1987.

Deductions Prohibited – Business and Property Income

Clause 6

ITA
18(1)(o.2)

Section 18 of the Act prohibits the deduction of certain outlays or expenses in computing a taxpayer's income from a business or property. New paragraph 18(1)(o.2), which is applicable after October 8, 1986, relates to retirement compensation arrangements. It denies any deduction for contributions made by a taxpayer under a retirement compensation arrangement, except as expressly permitted under new paragraph 20(1)(r).

Deductions Permitted – Business and Property Income

Clause 7

ITA
20(1)(r)

Section 20 of the Act sets out rules providing for specific deductions in computing a taxpayer's income from a business or property. New paragraph 20(1)(r), which is applicable after October 8, 1986, allows an employer a deduction for contributions made to the custodian of a retirement compensation arrangement in respect of his employees or former employees. The deduction is restricted to bona fide contributions for the benefit of such employees. The deduction will be denied where the contribution made is part of a series of contributions and refunds – for example, a contribution made at the year-end by an employer that will be refunded to him in the next year and that is made to obtain a deduction rather than to provide for retirement benefits.

Reserve for Banks

Clause 8

ITA
26(2)

Subsection 26(2) of the Act allows banks to deduct a special reserve for contingencies such as bad or doubtful debts or other losses on loans. It also prohibits banks from deducting the normal reserve for doubtful accounts allowed to most other taxpayers under paragraph 20(1)(l) of the Act, the normal bad debt expense deduction under paragraph 20(1)(p) and the special reserve allowed under subsection 33(1) to other taxpayers whose business includes the lending of money on security. Subsection 26(2) is amended, applicable to taxation years ending after January 15, 1987, as a consequence of the introduction of the new rules relating to loss carry-overs in section 111. The rule in new subsection 111(5.3) provides that where there has been a change of control of a corporation, any amount that would have been deductible by the corporation on account of a doubtful debt, if it were allowed a doubtful debt deduction, is treated as a separate debt and is required to be deducted as a bad debt under paragraph 20(1)(p) in computing its income for the taxation year that is treated by new subsection 249(4) as having ended immediately before the change of control.

The amendments to subsection 26(2) provide that the amount that a bank may deduct as a special reserve in computing its income for a taxation year is the amount that it could otherwise deduct under the subsection minus the aggregate of all amounts deducted under paragraph 20(1)(p) in computing its income for the year or a preceding taxation year in respect of a debt owed to the bank and included in its assets at the end of the year. This ensures that subsection 26(2) does not allow a deduction in respect of amounts treated as bad debts and allowed as a deduction by virtue of the special rule provided in new subsection 111(5.3).

Reserve for Lender of Money on Security

Clause 9

ITA
33(1)

Subsection 33(1) of the Act allows a taxpayer whose business includes the lending of money on security (such as a mortgage) to deduct a special reserve in lieu of the normal reserve for doubtful debts that is allowed to most other taxpayers under paragraph 20(1)(l). This subsection is amended, applicable to taxation years ending after January 15, 1987, as a consequence of the introduction of the new rules relating to loss carry-overs in section 111. The rule in subsection 111(5.3) provides that where there has been a change of control of a corporation, any amount that would have been deductible by the corporation on account of a doubtful debt, if it were allowed a doubtful debt deduction, is treated as a separate debt and is required to be deducted as a bad debt under paragraph 20(1)(p) in computing its income for the taxation year that is treated by new subsection 249(4) as having ended immediately before the change of control.

The amendment to the closing words of subsection 33(1) provides that the special reserve under that subsection is not available in respect of a debt that is deducted as a bad debt under paragraph 20(1)(p), whether the debt is established by the corporation to be a bad debt or is treated by new subsection 111(5.3) as a bad debt. This ensures that subsection 33(1) does not give rise to a double deduction in respect of such bad debts.

International Banking Centres

Clause 10

ITA 33.1

New section 33.1 of the Act establishes the concept of an international banking centre business and provides that certain financial institutions that carry on such a business from a designated branch or office in the metropolitan area of Montreal or Vancouver may exclude the income or loss therefrom in computing their income under the Act. The business of an international banking centre may be generally described as the making of loans to and acceptance of deposits from persons that are not resident in Canada.

An international banking centre business may be conducted in conjunction with and from the same branch or office at which other business activities are carried on by a taxpayer. In addition, the taxpayer may choose to designate more than one branch or office in Montreal or Vancouver as a place from which an international banking centre business will be conducted. However, for the purposes of this new section, the income or loss attributable to the international banking centre business of each branch or office must be determined on the basis that it constitutes a separate and distinct business of the taxpayer.

New section 33.1 is applicable to taxation years beginning after the date on which the enabling legislation receives Royal Assent.

ITA 33.1(1)

New subsection 33.1(1) sets out the definition of certain terms used in new section 33.1. In all cases the reference to "taxpayer" in the following commentary on new subsection 33.1(1) should be considered as a reference to "prescribed financial institution". It is intended that members of the Canadian Payments Association will be prescribed for the purposes of new section 33.1.

The term "eligible deposit" includes two types of deposit. The first is a deposit with a taxpayer by an arm's length, non-resident person where, at the time at which the definition is being applied, the deposit is recorded in the books of account of an international banking centre business of the taxpayer. The deposit will not constitute an eligible deposit, however, if at that time the taxpayer was obligated in any manner to repay any part of the deposit to a person resident in Canada. In addition, for the deposit to qualify, before it was recorded in the books of account of the international banking centre business the taxpayer is required to have made reasonable inquiries and had no reason to believe that any part of the deposit was made on behalf of, for the benefit of, or as a condition relating to any transaction with, a person resident in Canada.

Also qualifying as an eligible deposit is a deposit from another prescribed financial institution with whom the taxpayer is dealing at arm's length, provided that the deposit has been identified by the depositing institution as having been made from deposits recorded in the accounts of its international banking centre business and a reasonable rate of interest is paid or payable by the taxpayer on the deposit.

There are three types of "eligible loan". The first is a loan or deposit (both of which are referred to as a "loan" in paragraph (a) of this definition) made by a taxpayer to an arm's length, non-resident borrower where the following two conditions are met: first, no person resident in Canada and no person with whom the taxpayer is not dealing at arm's length may, at the time at which this definition is being applied, be obligated to pay any amount to the taxpayer in respect of the loan; and second, from the time that is the later of:

(1) the time the loan was made, and

(2) the earliest of

(a) the time when the loan was recorded in the accounts of a Canadian branch or office of the taxpayer,

(b) the conclusion of the first taxation year in respect of which the taxpayer has designated any branch or office as the location of an international banking centre business, and

(c) the end of 1992,

to the time at which this term is being applied, the loan must be recorded in the accounts of an international banking centre business of the taxpayer. As a result, existing loans that are held in foreign branches of a taxpayer may be placed in the accounts of an international banking centre business in the first year in which the taxpayer designates a branch or office under new subsection 33.1(3) as the location of the business, provided that this designation is made for a taxation year commencing before 1993 and that the loans are placed in the business before 1993.

A loan that satisfies these conditions will qualify as an eligible loan only if:

- in the case of a loan made before the end of the first year in respect of which the taxpayer has made a designation under new subsection 33.1(3) (but not including a loan recorded in the books of account of an international banking centre business of the taxpayer when it was made) or where the loan was a loan to a foreign bank, the taxpayer made reasonable inquiries and had no reason to believe that the borrower had used or would use the proceeds of the loan, directly or indirectly, to earn income in Canada or to make a loan to a Canadian resident; and

- in the case of any other loan, the taxpayer obtained a statement from the borrower that he would not use the proceeds of the loan directly or indirectly to earn income in Canada or to make a loan to a Canadian resident and had no reason to believe that the borrower would use the loan for either such purpose.

The second type of eligible loan so defined is a loan acquired by a taxpayer from a non-arm's length foreign bank before the earlier of the end of the first taxation year in respect of which the taxpayer has made a designation under new subsection 33.1(3) and the end of 1992. Such loans must also be to non-resident persons with whom the taxpayer is dealing at arm's length and neither a Canadian resident nor any person with whom the taxpayer is not dealing at arm's length can be obligated to repay the loan or any interest thereon to the taxpayer. Furthermore, the loan must be recorded in the accounts of the taxpayer's international banking centre business from the time at which the loan was first recorded in a Canadian branch or office of the taxpayer to the particular time at which this definition is being applied.

The third type of eligible loan so defined is a deposit made by the taxpayer to another prescribed financial institution, with which the taxpayer is dealing at arm's length, that is accompanied by written notice to the institution that the deposit is being made from deposits recorded in the accounts of the taxpayer's international banking centre business.

The definition "foreign bank" has the meaning given to that term under the Bank Act except that, for the purposes of section 33.1, an affiliate of a Schedule A bank is not precluded from coming within the definition.

On the basis of the definition of the term "non-resident" in subsection 248(1) of the Act, a "non-resident person" would be interpreted to mean "a person not resident in Canada". However, the definition "non-resident person" in new subsection 33.1(1) also includes a person in respect of whom a taxpayer has made reasonable inquiries and believes to be a person not resident in Canada.

ITA 33.1(2)

New subsection 33.1(2) of the Act contains interpretative rules that apply for the purposes of new section 33.1. Paragraphs 33.1(2)(a), (b) and (c) all relate to partnerships – paragraph (a) treats a partnership as a person; paragraph (b) treats a partnership and a person as not dealing at arm's length where a member of the partnership and that person are not at arm's length; and paragraph (c) treats a partnership as a non-resident person only where all of its members are non-residents. Paragraph 33.1(2)(d) provides that a deposit made by or a loan made to a non-resident person does not include a deposit made by or a loan made to that person's fixed place of business in Canada.

ITA 33.1(3)

New subsection 33.1(3) of the Act establishes: the taxpayers for which an exclusion of income or loss from an international banking centre business is available; the means by which a branch or office is to be designated as the location of an international banking centre business; the areas in which such a branch or office must be located; and that a taxpayer's income or loss for a taxation year from such a business is not to be taken into account in computing the taxpayer's income for the year.

The exclusion of a taxpayer's income or loss for a taxation year from an international banking centre business is available only where the taxpayer was, throughout the year, a prescribed financial institution. Members of the Canadian Payments Association are to be prescribed for the purposes of this section.

Furthermore, the exclusion of this income or loss for the year will arise only where a branch or office of the taxpayer has been designated for the year by the taxpayer as a place at which the taxpayer will be carrying on an international banking centre business. To be effective, this designation must be made by filing a prescribed form with the Minister of National Revenue on or before the 90th day of the year, and must not have been revoked by the taxpayer's filing of a prescribed form with the Minister on or before that same day. Finally, the designated branch or office must be situated in the metropolitan area of either Montreal or Vancouver.

Where all of the above conditions have been met, in computing a taxpayer's income for the year no addition or deduction is to be made in respect of the taxpayer's income or loss from the international banking centre business.

ITA
33.1(4)

New subsection 33.1(4) of the Act sets out certain assumptions to be used in computing the income or loss of a taxpayer from an international banking centre business.

Paragraph 33.1(4)(a) provides that the income or loss of the taxpayer's international banking centre business is to be computed as though it were a separate business of the taxpayer, the only income of which was from eligible loans for the period in the year during which they were recorded in the accounts of the business. As a separate business, the income therefrom is to be determined as though the taxpayer had no income other than from that business and was allowed no deductions except to the extent that they may reasonably be regarded as applicable to that business.

Paragraph 33.1(4)(b) sets out a formula by which the interest expense incurred by the taxpayer for the purpose of earning income for a taxation year from the international banking centre business is to be calculated. This formula may be expressed as follows:

$$A + \left(B \times \frac{A}{C}\right)$$

where: A is the total amount of interest for the year on eligible deposits recorded in the accounts of the international banking centre business;

B is the total of amounts each of which is the amount by which 96 per cent of eligible loans recorded in the accounts of the international banking centre business at the end of a day in the year exceeds the eligible deposits recorded in the accounts of the business at the end of that day; and

C is the total amount of eligible deposits recorded in the accounts of the taxpayer's international banking centre business at the end of all days in the year.

Briefly, the purpose of this formula is to impute an interest expense to the extent that eligible deposits are less than 96 per cent of loans on any given day. The following example illustrates the operation of this provision.

Assume that a taxpayer has a seven-day taxation year during which it maintains eligible deposits equal to 96 per cent of eligible loans on five of the seven days.

	Day 1	Day 2	Day 3	Day 4	Day 5	Day 6	Day 7
Eligible loans (@ 5%/day)	100	100	200	200	200	500	500
Eligible deposits (@ 4%/day)	96	96	96	192	192	192	480

Step 1: Determine extent of shortfall in eligible deposits on day 3 and day 6

Day 3 96% (200) – 96 = $ 96
Day 6 96% (500) – 192 = $288
$384

Step 2: Add eligible deposits outstanding at the end of each day in the year

$96 + 96 + 96 + 192 + 192 + 192 + 480 = $1344

Step 3: Calculate actual interest expense on eligible deposits

$1344 @ 4% = $53.76

Step 4: Calculate "Imputed interest"

$$\text{Actual interest (\$53.76)} \times \frac{\text{"Deposit shortfall" (\$384)}}{\text{Total eligible deposits (\$1344)}}$$

= $15.36

Step 5: Total interest expense

Aggregate of: Actual interest $53.76
Imputed interest 15.36
$69.12

It may be noted that $69.12 equals 4 per cent of 96 per cent of total eligible loans ($1800); however, the result will not be the same in a situation where deposits exceed 96 per cent of loans on certain days in the year. In the latter case, "excessive" deposit interest will not be available to carry over to days on which there is a shortfall in eligible deposits.

To complete the calculation of the international banking centre business income under this provision, the interest expense of $69.12 (which, for the purposes of this example, is assumed to be the only expense attributable to this business) is deducted from the interest generated from the eligible loans:

Interest revenue: 5% ($100 + 100 + 200 + 200 + 200 + 500 + 500)

=$90.00

Interest expense (69.12)
Income $20.88

ITA
33.1(5)

New subsection 33.1(5) of the Act reduces the amount of a taxpayer's income from an international banking centre business to the extent that 96 per cent of eligible loans may not be considered to have been matched by eligible deposits.

The aggregate determined under paragraph (a) is the total for each day of a year of the lesser of: (1) outstanding eligible deposits recorded in the accounts of the international banking centre business at the end of that day, and (2) 96 per cent of outstanding eligible loans recorded in the accounts of the international banking centre business at the end of that day. The lesser amount in respect of each day in the year is used to ensure that "excessive" deposits on one or more days in the year will not balance a shortfall arising on one or more other days. The aggregate determined under paragraph (b) is equal to 96 per cent of the total amount of outstanding eligible loans recorded in the accounts of the international banking centre business at the end of each day in the year. Accordingly, a taxpayer will obtain a full exclusion of any income from an international banking centre business only when eligible deposits equal (or exceed) 96 per cent of eligible loans on each day of the year.

The taxpayer's income for the year from the international banking centre business is that proportion of such income (determined according to the provisions of new subsection 33.1(4)) that the total of "matched eligible loans" determined under paragraph 33.1(5)(a) at the end of each day in the year is of the total of 96 per cent of all eligible loans outstanding at the end of each day in the year.

Continuing with the example set out above in the commentary under new subsection 33.1(4), of the \$20.88 of income, \$16.24 would be the exempt income of the international banking centre business as follows:

$$\$20.88 \times \frac{\$1344 \quad \text{(lesser of loans and deposits on each day)}}{\$1728 \quad \text{(96\% of aggregate outstanding loans for all days)}}$$

$$= \$16.24$$

The difference of \$4.64 (\$20.88 minus \$16.24) would be included in computing ordinary income for the year which is taxable under Part I of the Act.

ITA
33.1(6)

New subsection 33.1(6) of the Act provides that, where a taxpayer so elects, an eligible deposit recorded in the books of account of an international banking centre business of the taxpayer at the end of a particular day in the year is considered not to have been recorded in the books of that business during that day. Instead, it is considered to have been recorded throughout that day in the books of account of another international banking centre business designated by the taxpayer in his election. Elections under this provision must be made in the taxpayer's return of income for the taxation year to which the election relates, or in a prescribed form filed within 90 days following the mailing of a notice of assessment or a notification that no tax is payable for that year.

This provision allows a taxpayer with two or more international banking centre businesses to transfer eligible deposits from one such business to another for the purposes of new subsections 33.1(4) and (5). Where, for example, a taxpayer has eligible deposits in excess of 96 per cent of eligible loans in one international banking centre business and eligible deposits which fall short of 96 per cent of eligible loans in another, he may elect that a certain number of the deposits recorded in the first business be considered to be recorded in the second in order to obtain a closer matching and thereby increase the proportion of the income from his international banking centre businesses which qualifies for an exclusion in computing his income for the year. By virtue of new subsection 33.1(2) of the Act, only the amount of eligible deposits which exceeds 96 per cent of the eligible loans of an international banking centre business at the end of a day may be treated as eligible deposits of another international banking centre business by means of an election under this provision.

Where eligible deposits are "transferred" from one international banking centre business of a taxpayer to another and are recorded in the books of account of the second business throughout a day, interest payable on that deposit for that day is attributable to the second business for the purposes of new subsections 33.1(4) and (5).

ITA 33.1(7)

New subsection 33.1(7) of the Act provides that a taxpayer may elect to transfer eligible deposits under new subsection 33.1(6) only to the extent that the aggregate of such deposits recorded in the books of account of a particular international banking centre business of the taxpayer at the end of a day exceeds 96 per cent of the total outstanding amount of eligible loans recorded in the books of account of that business at the end of the day.

ITA 33.1(8)

New subsection 33.1(8) of the Act provides that no amount paid or payable by a taxpayer on a deposit for the period in a taxation year during which it was an eligible deposit is deductible otherwise than in computing the taxpayer's income or loss from an international banking centre business. Deposits from non-residents will be eligible deposits only during the period in which they are recorded in the accounts of an international banking centre business, whereas a deposit from an international banking centre business of another prescribed financial institution will be an eligible deposit at all times. Accordingly, interest expense attributable to the latter type of eligible deposit will never be deductible in computing a taxpayer's income other than from an international banking centre business.

ITA 33.1(9)

New subsection 33.1(9) of the Act applies where less than 90 per cent of a taxpayer's revenue from loans during the period in the year in which they were recorded in the accounts of the taxpayer's international banking centre business was derived from eligible loans in respect of which employees of the taxpayer actively participated in the functions of solicitation, negotiation, analysis or management thereof while employed at a branch or office designated as the location of an international banking centre business. Where this 90 per cent minimum requirement has not been met, the taxpayer's income, if any, for the year from that business will not be excluded from the taxpayer's income for the year.

This rule has two purposes – to allow the taxpayer some margin for error in recording non-eligible loans in the accounts of an international banking centre business, and to require that the taxpayer's employees at a branch or office in which the business is carried on actively participate in the making or management of the loan. The performance of one or more of the specified functions at the branch or office will satisfy the conditions of new subsection 33.1(9).

ITA
33.1(10)

New subsection 33.1(10) of the Act denies a deduction in certain circumstances in computing a taxpayer's income for an amount paid or payable on the taxpayer's indebtedness to another person. This includes situations where the taxpayer was or ought to have been aware, at the time the amount became owing, of an arrangement under which any portion of the amount owing might reasonably be regarded as having been provided directly or indirectly from proceeds of a loan recorded in the accounts of an international banking centre business of a prescribed financial institution and any person, including the taxpayer, has provided a statement to the institution that the proceeds of the loan would not be used directly or indirectly for the purpose of earning income in Canada or making a loan to any person other than a non-resident person.

ITA
33.1(11)

New subsection 33.1(11) of the Act contains three rules that clarify the application of new section 33.1. Paragraph (a) confirms that a loan or deposit (both of which are referred to as a loan in this paragraph) that at any time ceases to be an eligible loan, otherwise than by reason of its disposition by the taxpayer to another person, is treated as having been disposed of by the taxpayer in the course of carrying on an international banking centre business for proceeds equal to its fair market value at that time. This ensures that any losses which have accrued in respect of eligible loans will be losses from the international banking centre business and not another business of the taxpayer. The taxpayer is considered to have reacquired the loan immediately after that time at a cost equal to its fair market value.

Paragraph (b) confirms that a loss of a taxpayer from an international banking centre business is not to be included in computing the taxpayer's non-capital loss for the year. This denies any carry-over of any such loss in calculating taxable income in any year.

Paragraph (c) ensures that any income from a taxpayer's international banking centre business which, as a result of new subsection 33.1(5), does not qualify for an exclusion under new subsection 33.1(3) is to be added in computing the taxpayer's income for the year.

ITA
33.1(12)

New subsection 33.1(12) of the Act requires a taxpayer that designates a branch or office as the location of an international banking centre business for a taxation year to file with the Minister of National Revenue a return in prescribed form containing prescribed information within six months following the end of the year.

Scientific Research and Experimental Development

Clause 11

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

Subsection 37(1) of the Act allows a taxpayer carrying on business in Canada to deduct certain current and capital expenditures in respect of scientific research and experimental development. Such expenditures may be claimed in the year they are made or they may be carried forward to any future year if, in that future year, the business to which the expenditures relate is still carried on and the taxpayer makes expenditures in respect of scientific research and experimental development.

The amendments to section 37 introduce a restriction on the carry-forward of scientific research and experimental development expenditures of a corporation where there has been a change of its control. In general, this restriction is that such expenditures incurred before control of a corporation is acquired may be carried forward to be deducted in computing its income for a subsequent taxation year only where the business to which the expenditures related is carried on by the corporation throughout the year for profit or with a reasonable expectation of profit and only to the extent of its income for the year (before making any deduction under subsection 37(1)) from that or a similar business. This rule corresponds with that provided in section 111 of the Act relating to the deduction of losses following a change of control of a corporation.

In technical terms, this restriction is implemented by introducing new paragraph 37(1)(h) and subsection 37(6.1) which together reduce a corporation's pool of undeducted scientific research and experimental development expenditures to nil at the time control of the corporation changes. In a subsequent taxation year throughout which the business to which the expenditures related is carried on for profit or with a reasonable expectation of profit, the corporation's pre-acquisition pool of expenditures is reinstated to the extent of the corporation's income for the year (before making any deduction under subsection 37(1)) from the business and all similar businesses. The amount thus restored to the pool in that subsequent year will be allowed as a deduction under subsection 37(1) in computing the corporation's income for that year.

The amendments to section 37 are applicable to acquisitions of control occurring after January 15, 1987 other than acquisitions of control occurring before 1988 where the persons acquiring the control were obliged on January 15, 1987 to acquire the control pursuant to the terms of agreements in writing entered into on or before that date.

Capital Gain or Loss Computation Rules

Clause 12

ITA
40(2)(i)

Paragraph 40(2)(i) of the Act requires that a taxpayer's capital loss on the disposition of shares of a prescribed venture capital corporation or a prescribed labour-sponsored venture capital corporation be reduced by the amount of any provincial assistance received by him in respect of the shares. As a result, the loss will be determined by reference to the cost of the shares net of any tax credit, grant or other assistance received by the taxpayer. This paragraph is amended, for the 1986 and subsequent taxation years, as a consequence of the amendments to paragraph 53(2)(k) relating to prescribed provincial stock savings plans. This paragraph provides that any grant or other provincial assistance for shares held in such plans does not reduce their adjusted cost base for the purpose of determining any capital gain on a sale of the shares. The amendment to paragraph 40(2)(i) provides that any capital loss is to be reduced to the extent of any such assistance received by the taxpayer.

Adjustments to Cost Base

Clause 13

Section 53 of the Act sets out the rules for determining the adjusted cost base of property for the purpose of calculating any capital gain or loss on its disposition.

Subclause 13(1)

ITA
53(2)(b.2)

New paragraph 53(2)(b.2) of the Act, applicable to taxation years ending after January 15, 1987, requires a deduction in computing the adjusted cost base of non-depreciable capital property of a corporation that has undergone a change of control. The amount of the deduction is determined under new paragraph 111(4)(c) of the Act, as explained in the commentary on that provision.

Subclause 13(2)

ITA
53(2)(k)(i)(C)

Paragraph 53(2)(k) of the Act provides that the adjusted cost base of a property is reduced by the amount of government assistance received in respect thereof. However, clause 53(2)(k)(i)(C) provides an exclusion from this reduction for provincial government assistance in respect of shares of prescribed venture capital corporations and prescribed labour-sponsored venture capital corporations. For the 1986 and subsequent taxation years, this exception is expanded to include government assistance relating to shares of a taxable Canadian corporation that are held in a prescribed stock savings plan.

This change is intended to apply to the stock savings plan introduced by the Province of Alberta in 1986 and similar plans.

Capital Gains – Definitions

Clause 14

ITA
54(i)(iii)

Paragraph 54(i) of the Act defines the term "superficial loss" and subparagraph (iii) thereof excludes losses arising from certain dispositions from that definition. Subparagraph (iii) is amended, as a consequence of the introduction of new paragraph 33.1(11)(a) of the Act, relating to eligible loans held by a taxpayer in connection with an international banking centre business. Any loss arising when any such loan ceases to be an eligible loan will not be considered to be a superficial loss of the taxpayer. This amendment applies to taxation years that begin after the date on which the enabling legislation receives Royal Assent.

Other Income

Clause 15

Section 56 of the Act lists certain types of income that are required to be included in computing the income of a taxpayer for a taxation year from a source other than property, business or employment and other than from the disposition of capital properties.

Subclause 15(1)

ITA
56(1)(a)(i) and (ii)

Subparagraph 56(1)(a)(i) of the Act requires pensions, including the Old Age Security pension and pensions under the Canada Pension Plan or a similar provincial plan, to be included in income. Subparagraph 56(1)(a)(ii) requires retiring allowances, other than amounts received out of or under an employee benefit plan, to be included in income. Subparagraphs (i) and (ii) are amended to exclude from the amount included in income under paragraph (a) those benefits received out of a retirement compensation arrangement (RCA) that are dealt with in new paragraphs 56(1)(x) and (z). New paragraphs (x) and (z), together with new paragraph (y), provide rules requiring a taxpayer to include in computing income benefits received out of an RCA and any proceeds from the disposition of an interest in an RCA. This amendment, which is applicable after October 8, 1986, is strictly consequential on the introduction of the new provisions relating to RCAs.

Subparagraph (i) is also amended, applicable to the 1987 and subsequent taxation years, to ensure that payments out of a prescribed provincial pension plan are included in income. It is intended that the Saskatchewan Pension Plan will be a prescribed provincial pension plan for this purpose. (The deduction with respect to contributions to this plan is provided in an amendment to section 60 – see the commentary on paragraph 60(v).)

Subclause 15(2)

ITA
56(1)(n)

Paragraph 56(1)(n) of the Act requires that, subject to a $500 *de minimis* rule, a taxpayer must include in his income the amount of any prize received by him for achievement in a field of endeavour ordinarily carried on by him. This paragraph is amended for the 1983 and subsequent taxation years to exclude from its ambit certain types of prizes that will be prescribed by regulation. These will be limited to prizes recognized by the general public and which are awarded for meritorious endeavour in the arts, sciences or service to the public, but will not include an amount that can reasonably be regarded as an amount received as compensation for services rendered or to be rendered.

Subclause 15(3)

ITA
56(1)(x), (y) and (z)

New paragraphs 56(1)(x), (y) and (z) of the Act, which are applicable after October 8, 1986, provide rules requiring a taxpayer to include in computing income benefits received out of a retirement compensation arrangement (RCA) and any proceeds from the disposition of an interest in such an arrangement. Paragraph 56(1)(a), which deals with pensions and certain other retiring allowances, is amended to exclude benefits received out of an RCA that are dealt with in paragraphs 56(1)(x) and (z).

New paragraph 56(1)(x) of the Act requires benefits received in a taxation year by a taxpayer or another person out of an RCA to be included in computing the taxpayer's income for the year where the benefits relate to the taxpayer's office or employment. Thus, for example, the amount of any benefit received by a taxpayer's spouse from an arrangement established in respect of the taxpayer's retirement must be included in computing the taxpayer's income and not the income of the recipient spouse. An exception is made for a return of contributions or other amounts paid out of an arrangement that are included in the income of the employer under new paragraph 12(1)(n.3).

New paragraph 56(1)(y) requires a taxpayer's proceeds from the disposition by him of an interest in an RCA to be included in computing his income. Reference should also be made to new paragraph 60(u) which allows a deduction for the cost of acquiring the interest.

New paragraph 56(1)(z) requires a taxpayer to include in his income amounts received by him out of an RCA where the benefits relate to another person's employment. An exception is made where the amounts are required by new paragraph 56(1)(x) or subsection 70(2) to be included in the income of another person who is resident in Canada. This may occur, for example, where the benefits are payable under the plan to the employee's spouse but are nevertheless taxable in the hands of the employee under new paragraph 56(1)(x). This may also occur where the employee dies and the benefits are paid to his estate but are included in the employee's income under subsection 70(2) of the Act. A further exception applies where the amounts are required by new paragraph 12(1)(n.3) to be included in the taxpayer's income – for example, where the amount represents a return of the employer's contributions or an amount forfeited by one of his employees under the terms of the arrangement. This latter exception prevents the double inclusion of amounts received by an employer – once under paragraph 12(1)(n.3) and again under new paragraph 56(1)(z).

A taxpayer required to include an amount in computing his income under new paragraphs 56(1)(x), (y) or (z) may be entitled to certain deductions under new paragraphs 60(t) or (u) – see the commentary on those provisions.

Subclause 15(4)

ITA
56(2)

Subsection 56(2) of the Act provides that where a taxpayer directs or concurs in the payment of an amount to another person, that amount shall be included in the taxpayer's income where, if it had been paid to him, it would have been so included. This subsection is amended, for the 1987 and subsequent taxation years, to provide an exclusion where a taxpayer directs that a portion of his Canada Pension Plan be paid to his spouse under recently enacted amendments to the Canada Pension Plan or under a similar provision of a provincial pension plan. The result is that the pension will be included in the income of the spouse who receives it rather than in the income of the spouse who earned it.

Subclause 15(5)

ITA
56(4)

Subsection 56(4) provides that where a right to receive income is transferred by a taxpayer to a person with whom he does not deal at arm's length, income received under that right is income of the transferor except in specified circumstances. This subsection is amended to add an exception for a division of benefits between spouses pursuant to the terms of the Canada Pension Plan. This amendment is applicable to the 1987 and subsequent taxation years.

Subclause 15(6)

ITA
56(10) and (11)

In the absence of special rules, a plan or arrangement between an employer and employee might at the same time constitute any combination of an employee benefit plan, a salary deferral arrangement and a retirement compensation arrangement (RCA). Although such circumstances will be rare, the special rules necessary to deal with such hybrid plans are provided in new subsection 56(10), which is applicable after October 8, 1986. This new subsection provides that where an RCA is part of a plan that provides benefits other than those under the RCA, the RCA is treated as a separate arrangement. Further, benefits paid out of any such hybrid plan are considered to have been made

(a) first, out of that part of the plan that is a salary deferral arrangement, as provided under subsection 6(14), and

(b) next, out of that part of the plan that is an RCA, unless a different ordering of payments is provided in the plan itself.

To give effect to these rules it is important for the custodian of any such hybrid plan to maintain accounting records to separate those transactions (contributions, earnings and distributions) that relate to the separate RCA component.

New subsection 56(11), applicable after October 8, 1986, provides a special rule that applies where a trust governed by a retirement compensation arrangement buys, sells or permits the use of property for a price that differs from its fair market value so that the value of the trust is reduced. In these circumstances, an amount equal to the difference between the price and the fair market value is considered to be received under the arrangement by the person who bought, sold or used the property. The effect of this is to require the difference to be included in the income of the person who would be taxable on a distribution out of or under the arrangement as provided in paragraphs 56(1)(x) or (z).

Resource Property Dispositions

Clause 16

Subclauses 16(1) to (5)

ITA 59(3.3)

Subsection 59(3.3) of the Act provides for inclusions in income on dispositions of resource properties with respect to the recovery or recapture of resource expenditures that earned depletion, supplementary depletion, frontier depletion or mining exploration depletion allowance. The amendments to this subsection are strictly consequential on the introduction of the successor corporation rules in new section 66.7 of the Act. These amendments simply remove the references to second successor corporations and are applicable to taxation years ending after February 17, 1987.

Subclause 16(6)

ITA 59(3.4)

Paragraphs 59(3.4)(a) and (b) of the Act define "successor corporation" and "second successor corporation" for the purposes of the special rules in subsection 59(3.3) relating to dispositions of resource property the cost of which entitled the taxpayer or any predecessor to a depletion allowance. The amendment to paragraph (a) is consequential on the amendment to subsection 29(25) of the *Income Tax Application Rules, 1971* and the introduction of new subsections 66.7(1) and (3) to (5) of the Act. Paragraph (b) is repealed as a result of the changes relating to the successor corporation rules in new section 66.7 of the Act. These amendments are applicable to taxation years ending after February 17, 1987.

Deductions in Computing Income

ITA
60(t), (u) and (v)

Clause 17

Section 60 of the Act, which provides for various deductions in computing income, is amended by the addition of three new deductions in new paragraphs (t), (u) and (v).

New paragraph 60(t) of the Act, which is applicable after October 8, 1986, allows a deduction for a taxation year to an individual who is required under paragraph 56(1)(x) or (z) or subsection 70(2) to include benefits paid out of a retirement compensation arrangement (RCA) in computing his income for the year. This deduction permits a beneficiary to recover his contributions to an RCA and, where the beneficiary was resident in Canada and acquired his interest in an RCA from another person, to recover also the purchase price paid, before any benefits received by him out of the arrangement are taxable in his hands. Contributions to an RCA by a taxpayer other than an employer are not deductible in computing his income.

New paragraph 60(u) of the Act, which is applicable after October 8, 1986, permits a person who disposes of an interest in an RCA a deduction from the proceeds that are required by new paragraph 56(1)(y) to be included in computing his income. The deduction in any year, which cannot exceed the amount so included in that year, will be the amount by which the total of his purchase price of the interest paid to a person resident in Canada and any non-deductible contributions made by him to the arrangement exceeds all amounts previously deducted under the paragraph and all amounts in respect of the arrangement that were deducted in the year or in preceding years under new paragraph (t) as described above.

New paragraph 60(v) of the Act allows a taxpayer to deduct contributions to his account under certain provincial pension plans (the Saskatchewan Pension Plan is the only such plan presently in existence). The deduction in any year is limited to the least of

(a) the amount he contributed to the plan in the year or within 60 days after the end of the year,

(b) an amount prescribed in respect of the plan ($1200 for 1987 and $600 for subsequent years), and

(c) the amount of his otherwise unused room to make deductible contributions to an RRSP for the year.

New paragraph 60(v) is applicable to the 1987 and subsequent years; however, a contribution made in 1986 will be deductible in computing income for 1987.

Successor Rules

Clauses 18 to 23 and Clauses 73 and 74

ITA
66 to 66.7

ITAR, 1971
29(25) and (29)

Under the existing law, where a corporation (a successor corporation) acquires all or substantially all of the resource properties of another person (a predecessor), the successor corporation may deduct the unused resource expenses of the predecessor to the extent of the successor corporation's income from the resource properties acquired from the predecessor. This is commonly referred to as the first successor rule. This rule is contained in subsection 29(25) of the ITAR, 1971 and subsections 66(6) and (8), 66.1(4), 66.2(3) and 66.4(3) of the Act.

If another corporation (a second successor corporation) acquires all or substantially all of the resource properties (including the predecessor's properties) of the first successor corporation, the second successor corporation may deduct the unused resource expenses of the predecessor not deducted by the first successor corporation to the extent of the second successor corporation's income from the predecessor's properties acquired from the first successor corporation. This is commonly referred to as the second successor rule. This rule is contained in subsection 29(29) of ITAR and subsections 66(7) and (9), 66.1(5), 66.2(4) and 66.4(4) of the Act.

Currently, there is no third or subsequent successor rule. Therefore, for example, where a corporation (a third successor corporation) acquires all or substantially all of the resource properties (including the predecessor's properties) of the second successor corporation, the third successor corporation cannot deduct the unused resource expenses of the predecessor. Thus, to the extent that the predecessor's unused resource expenses have not been deducted by the first or second successor corporation, they are lost as deductions.

New section 66.7 of the Act replaces the first and second successor rules and provides rules covering any number of transfers of resource properties.

Resource Exploration and Development Expenses

Clause 18

Subclauses 18(1) and (2)

ITA
66(6) to (9)
66(11.1) and (11.2)

Subsections 66(6) to (9) and 66(11.1) and (11.2) of the Act are repealed. Subsections 66(6) to (9) of the Act are the first and second successor rules for Canadian exploration and development expenses and foreign exploration and development expenses. Subsections 66(11.1) and (11.2) of the Act provide for the application of the successor rules where the control or tax-exempt status of a corporation changes. These subsections are repealed and the successor rules relating to such expenses are now included in new section 66.7 of the Act. These amendments are applicable to taxation years ending after February 17, 1987.

Subclause 18(3)

ITA 66(11.3)

The amendment to subsection 66(11.3) of the Act is consequential on the introduction of new rules relating to changes of control in subsection 66.7(10). This amendment is applicable to taxation years ending after February 17, 1987.

Subclause 18(4)

ITA 66(11.4) and (11.5)

New subsection 66(11.4) of the Act provides the special rule, announced on January 15, 1987, that applies where there is a change of control of a corporation that was not a principal-business corporation immediately before the 12-month period preceding the change of control. In these circumstances, any Canadian or foreign resource property acquired by the corporation in that period is considered to have been acquired at the time control changes for the purpose of calculating the corporation's

- foreign exploration and development expenses,
- cumulative Canadian development expense, and
- cumulative Canadian oil and gas property expense.

Where the property is disposed of before control changes, it is considered, for the purposes of those expense pools, to have been acquired by the corporation immediately before being disposed of.

This special rule does not apply where the corporation acquired the property from a person or persons related to the corporation throughout the 12-month period.

The purpose of this rule is to prevent the transfer of resource properties to a taxable corporation in contemplation of a change of control in order to reduce its taxable income where the persons acquiring control would not be in a position to use the deductions in respect of those properties.

This new rule applies with respect to acquisitions of property after January 15, 1987 other than property acquired before 1988 where the purchaser was obliged on January 15, 1987 to acquire the property pursuant to agreements in writing entered into on or before that date.

ITA 66(11.5)

New subsection 66(11.5) of the Act provides a special rule for the purposes of the related person exclusion in subsection 66(11.4). Where a corporation has been incorporated or otherwise formed during the 12-month period referred to in subsection 66(11.4), it is treated as having been in existence during the period commencing immediately before the 12-month period and ending immediately after it was incorporated or otherwise formed, and as having been related throughout that period to the person or persons to whom it was related throughout the period of its existence ending immediately before the change.

Subclause 18(5)

ITA
66(13.1)

New subsection 66(13.1) of the Act limits the amount of foreign exploration and development expenses, Canadian development expenses and Canadian oil and gas property expenses that a taxpayer may deduct in computing his income where the amount is based on a percentage of the unclaimed balance. For a taxation year that is less than 51 weeks, the amount that may be deducted cannot exceed that portion of the amount otherwise determined that the number of days in the taxation year is of 365. This subsection applies to taxation years commencing after June 3, 1987.

Subclause 18(6)

ITA
66(15)

Subsection 66(15) of the Act provides definitions for expressions used in sections 66, 66.1, 66.2 and 66.4. The opening words of this subsection are amended to provide that the definitions therein apply also for the purposes of the new successor rules provided in section 66.7 of the Act.

Subclause 18(7)

ITA
66(15)(g.11)

New paragraph 66(15)(g.11) of the Act defines an "original owner" of a resource property for the purposes of the new successor rules as a person

(a) who owned a resource property and disposed of it to a corporation in circumstances where the successor rules apply to the corporation in respect of the property, and

(b) who would, but for the disposition and the fact that after the disposition his resource pools are reduced to zero, be entitled in computing his income for a taxation year ending after the disposition to a deduction in respect of the resource expenses incurred by him prior to the disposition.

This paragraph is applicable to taxation years ending after February 17, 1987.

Subclause 18(8)

ITA
66(15)(g.4)

New paragraph 66(15)(g.4) of the Act defines a "predecessor owner" of a resource property for the purposes of the new successor rule as a corporation

(a) that acquired the resource property in circumstances where the successor rules apply to it in respect of the property,

(b) that disposed of the property to another corporation in circumstances where the successor rules apply to the other corporation in respect of the property, and

(c) that would, but for the disposition and the fact that after the disposition it is treated as never having acquired the property, be entitled in computing its income from the property for a taxation year ending after the disposition to a deduction in respect of the resource expenses incurred by an original owner of the property.

This paragraph is applicable to taxation years ending after February 17, 1987.

Subclause 18(9)

ITA
66(15)(h.01) and (h.02)

New paragraph 66(15)(h.01) of the Act defines "production" from a resource property. This definition is relevant for the purpose of determining the extent to which resource expenses incurred by an original owner or predecessor may be deducted by a successor under the successor rules provided in new section 66.7 of the Act.

This new definition is applicable to taxation years ending after February 17, 1987.

New paragraph 66(15)(h.02) of the Act defines a "reserve amount" included in the eligible income of a successor under new section 66.7 for the purposes of deducting expenses incurred by the original owner. The reserve amount is the amount by which the amount included in the successor's income under subsection 59(2) of the Act in respect of a reserve deducted by an original or predecessor owner of property exceeds the amounts deducted from income by the successor for the year as a reserve in respect of the disposition of property by the original or predecessor owner of the property.

The provisions of the Act relating to the establishing of new reserves on the disposition of resource properties were repealed in 1981. Therefore, for the purposes of the successor rules, the reserve amount is relevant to the corporation only where the original owner or predecessor owner deducted a reserve in respect of Canadian resource property disposed of by the original owner prior to November 13, 1981. This paragraph is applicable to taxation years ending after February 17, 1987.

Canadian Exploration Expense

Clause 19

Section 66.1 of the Act provides rules relating to the deduction of Canadian exploration expenses.

Subclause 19(1)

ITA
66.1(1)(a)

Subsection 66.1(1) and paragraph 59(3.2)(b) of the Act taken together require a taxpayer to include in computing his income for a taxation year any negative balance in his cumulative Canadian exploration expense (CCEE) pool at the end of the year. The amendment to paragraph 66.1(1)(a) is strictly consequential on the introduction of new subparagraph

66.1(6)(b)(xii) of the Act. The effect of this new subparagraph is to reduce the taxpayer's CCEE to nil after the disposition of its Canadian resource properties in circumstances where the successor rules applied to the disposition. This amendment is applicable to taxation years ending after February 17, 1987.

Subclause 19(2)

ITA
66.1(4) and (5)

This subclause repeals subsections 66.1(4) and (5) of the Act – the old first and second successor rules in respect of Canadian exploration expenses. These subsections are replaced for taxation years ending after February 17, 1987 by the new successor rules provided in subsection 66.7(3) of the Act.

Subclause 19(3)

ITA
66.1(6)(b)(xii)

Paragraph 66.1(6)(b) of the Act provides the definition of "cumulative Canadian exploration expense" (CCEE). New subparagraph 66.1(6)(b)(xii) requires a taxpayer to reduce his CCEE account to zero after the disposition by him of his Canadian resource properties in circumstances where the successor rules apply to the disposition. This amendment is applicable to taxation years ending after February 17, 1987.

Subclause 19(4)

ITA
66.1(10) and (11)

This subclause repeals subsections 66.1(10) and (11) of the Act. These subsections provided special rules relating to the reclassification by successor corporations of a taxpayer's Canadian development expenses (CDE) under subsection (9). These rules allowed a successor corporation to reclassify unclaimed CDE of a predecessor incurred after March, 1987 if the predecessor would have been entitled to do so under the rules provided in subsection (9). New subsection 66.7(9) of the Act replaces these subsections. These amendments are applicable to taxation years ending after February 17, 1987.

Canadian Development Expense

Clause 20

Section 66.2 of the Act provides rules relating to the deduction of Canadian development expenses.

Subclause 20(1)

ITA
66.2(1)(a)(i)

Subsection 66.2(1) and paragraph 59(3.2)(c) of the Act taken together require a taxpayer to include in computing his income for a taxation year any negative balance in his cumulative Canadian development expense (CCDE) account at the end of the year. The amendment to subparagraph

66.2(1)(a)(i) is strictly consequential on the introduction of new subparagraph 66.2(5)(b)(xiii) of the Act. The effect of this new subparagraph is to reduce the taxpayer's CCDE to nil after the disposition of its Canadian resource properties in circumstances where the successor rules applied to the disposition. This amendment is applicable to taxation years ending after February 17, 1987.

Subclause 20(2)

ITA
66.2(3) and (4)

This subclause repeals subsections 66.2(3) and (4) of the Act – the old first and second successor rules in respect of Canadian development expenses. These subsections are replaced for taxation years ending after February 17, 1987 by the new successor rules provided in subsection 66.7(4) of the Act.

Subclauses 20(3), (4) and (5)

ITA
66.2(5)(b)(v), (x) and (xiii)

Paragraph 66.2(5)(b) of the Act provides the definition of "cumulative Canadian development expense" (CCDE).

Subparagraph 66.2(5)(b)(v) of the Act provides for a reduction of the CCDE by the amount of proceeds on the sale of Canadian mining properties. It also requires the proceeds of a disposition of a mining property that was acquired from an original owner or predecessor owner to be reduced by the balance of any undeducted Canadian development expenses acquired from the original owner or predecessor owner.

Subparagraph 66.2(5)(b)(x) of the Act provides for the reduction of CCDE by the credit balance of the taxpayer's cumulative Canadian oil and gas property expense account. The amount of this credit may be reduced by the lesser of the balance of unclaimed development expenses acquired from an original owner or predecessor owner and the amount by which the amount of proceeds from the sale of oil and gas properties acquired from the original owner or predecessor owner exceeds the amount of undeducted Canadian oil and gas property expenses acquired from the original owner or predecessor owner.

The amendments to subparagraphs 66.2(5)(b)(v) and (x) are strictly consequential on the repeal of the old first and second successor rules and their replacement by new section 66.7 of the Act.

New subparagraph 66.2(5)(b)(xiii) of the Act requires a taxpayer to reduce his CCDE account to zero after the disposition by him of his Canadian resource properties in circumstances where the successor rules applied to the disposition.

The amendments to paragraph 66.2(5)(b) are applicable to taxation years ending after February 17, 1987.

Canadian Oil and Gas Property Expense

Clause 21

Section 66.4 of the Act provides rules relating to the deduction of Canadian oil and gas property expenses.

Subclause 21(1)

ITA
66.4(1)(a)

Subsection 66.4(1) of the Act requires a taxpayer to credit his cumulative Canadian development expense for a taxation year by any negative balance in his cumulative Canadian oil and gas property expense (CCOGPE) pool at the end of the year. The amendment to paragraph 66.4(1)(a) is strictly consequential on the introduction of new subparagraph 66.4(5)(b)(ix) of the Act. The effect of this new subparagraph is to reduce the amount of the taxpayer's CCOGPE to nil after the disposition of its Canadian resource properties in circumstances where the successor rules applied to the disposition. This amendment is applicable to taxation years ending after February 17, 1987.

Subclause 21(2)

ITA
66.4(3) and (4)

This subclause repeals subsections 66.4(3) and (4) of the Act – the old first and second successor rules in respect of Canadian oil and gas property expenses. These subsections are replaced for taxation years ending after February 17, 1987 by the new successor rules provided in subsection 66.7(5) of the Act.

Subclauses 21(3) and (4)

ITA
66.4(5)(b)(v) and (ix)

Paragraph 66.4(5)(b) of the Act provides the definition of "cumulative Canadian oil and gas property expense" (CCOGPE).

Subparagraph 66.4(5)(b)(v) of the Act provides for a reduction of the CCOGPE by the amount of proceeds on the sale of Canadian oil and gas properties. The amendment to the subparagraph requires the proceeds on the disposition of an oil and gas property acquired from an original owner or predecessor owner to be reduced by the balance of any undeducted Canadian oil and gas property expenses acquired from the original owner or predecessor owner.

The amendments to subparagraph 66.4(5)(b)(v) are strictly consequential on the repeal of the old first and second successor rules and their replacement by new section 66.7 of the Act.

New subparagraph 66.4(5)(b)(ix) of the Act requires a taxpayer to reduce his CCOGPE account to nil after the disposition by him of his Canadian resource properties in circumstances where the successor rules applied to the disposition.

The amendments to paragraph 66.4(5)(b) are applicable to taxation years ending after February 17, 1987.

Cumulative Offset Account

Clause 22

ITA
66.5(3)

Section 66.5 of the Act provides rules relating to the deduction of the cumulative offset account. This account represents the amount of Canadian exploration and development expenses that were utilized to reduce a corporation's liability for tax (PGRT) under the *Petroleum and Gas Revenue Tax Act*. Under that Act, such expenses could be utilized to reduce the PGRT liability by $3 for each $10 of eligible exploration and development expenses. These expenses could subsequently be deducted under section 66.5 of the *Income Tax Act* by paying the special 30 per cent tax imposed under Part IX of the Act (section 196) – in effect by repaying the benefit obtained under the PGRT Act in respect of such expenses.

New subsection 66.5(3) of the Act provides that on the change of control of a corporation at any time after June 3, 1987, the amount deductible by it in respect of its cumulative offset account will be subject to the limitations of the successor rules. Thus, the deduction is limited to the corporation's income from Canadian resource properties owned by it immediately before the change of control. Subsection 66.5(3) is applicable to taxation years ending after June 3, 1987.

Successor Rules

Clause 23

Subclause 23(1)

ITA
66.7

Section 66.7 of the Act is new. It provides the successor rules which replace the existing first and second successor rules. The principal change in the new rules is that the deduction of resource expenses will no longer be denied following a transfer of resource properties by a second successor corporation. The application of new section 66.7 of the Act is illustrated by the following example:

> Assume Corporation A ("A") incurs $1,000 of Canadian resource expenses before it disposes of its only Canadian resource property – X. Corporation B ("B") then acquires property X from A. A and B elect to use the new successor rules. On the disposition of the property, A is an original owner and B is the successor owner of the property. B may deduct the unused resource expenses of A (assume $800) to the extent of its income from, including the sale of, the property. After the disposition, A's resource expense pools are reduced to nil (new subsections 66.7(12) and (13) of the Act). Therefore, A cannot take

any deductions in respect of resource expenses it incurred prior to the disposition in computing its income for the taxation year in which the disposition took place or any subsequent taxation year.

Assume further that after the acquisition of property X, B has two properties – X and, its previously-owned property, Y. B incurs $3,000 of Canadian resource expenses before it disposes of properties X and Y. Corporation C ("C") then acquires properties X and Y from B. C and B elect to use the new successor rules. On the disposition of properties X and Y, B is an original owner of property Y and is both an original owner and the predecessor owner of property X – an original owner with respect to the $3,000 of resource expenses it incurred before it disposed of the properties and the predecessor owner of property X with respect to the unused resource expenses of A (assume $600). C is the successor owner of both properties X and Y and may use the unused resource expenses of A ($600) and B (assume $2,500). C may deduct the $600 to the extent of its income from property X and the $2,500 to the extent of its income from properties X and Y. As noted below, the same income cannot be used more than once. After the disposition, B's resource expense pools are reduced to nil (new subsections 66.7(12) and (13) of the Act) and B (as a predecessor owner of property X) is treated as never having acquired property X from A (new subsections 66.7(14) and (15) of the Act).

After the acquisition of properties X and Y, C has three properties – X, Y and, its previously-owned property, Z. C incurs $4,000 of Canadian resource expenses before it disposes of the properties. Corporation D ("D") then acquires properties X, Y and Z from C. C and D elect to use the new successor rules. On the disposition, C is a predecessor owner of properties X and Y with respect to the portion of unused resource expenses of A and B not deducted by C. C is an original owner of properties X, Y and Z with respect to the $4,000 of resource expenses it incurred. D is the successor owner of properties X, Y and Z and may use the unused resource expenses of A, B and C, which are assumed to be $400, $2,000 and $3,500, respectively. D may deduct the $400 to the extent of its income from property X, the $2,000 to the extent of its income from properties X and Y, and the $3,500 to the extent of its income from properties X, Y and Z. As noted below, the same income cannot be used more than once. After the disposition, C's resource expense pools are reduced to nil and C (as a predecessor owner of properties X and Y) is treated as never having acquired those properties from B.

The decision as to the ordering of deductions in respect of an original owner's or a predecessors owner's unused resource pools is at the discretion of the successor corporation. However, the same income in a year cannot be used more than once to reduce the successor owner expenses acquired from an original owner or predecessor owner.

ITA
66.7(1) and (2)

New subsections 66.7(1) and (2) of the Act set out the successor rules in respect of Canadian exploration and development expenses and foreign exploration and development expenses, respectively.

ITA
66.7(3), (4) and (5)

New subsections 66.7(3), (4) and (5) of the Act set out the successor rules in respect of Canadian exploration expenses, Canadian development expenses and Canadian oil and gas property expenses, respectively.

ITA
66.7(6)

New subsection 66.7(6) of the Act provides that new subsection 29(25) of the *Income Tax Application Rules, 1971* and new subsections 66.7(1) to (5) of the Act – the new successor rules – do not apply in respect of Canadian or foreign resource property acquired

(a) by way of an amalgamation of a parent and one or more of its subsidiary wholly-owned corporations or of two or more corporations each of which is a subsidiary wholly-owned corporation of the same corporation (subsection 87(1.2)),

(b) by way of the winding-up of a subsidiary corporation into its parent (subsection 88(1.5)), or

(c) by a corporation before February 18, 1987, where the corporation would not be entitled under the old first and second successor rules, as they applied to taxation years ending before February 18, 1987, to a deduction in respect of resource expenses incurred by a previous owner of the property before the acquisition of the property by the corporation. For example, a corporation that is a third successor in respect of property acquired before February 18, 1987 cannot use the new successor rules.

ITA
66.7(7) and (8)

New subsection 66.7(7) of the Act applies to the acquisition of Canadian resource properties and provides that the new successor rule will now apply in circumstances where the old first and second successor rule applied. Under the new rule, as under the old rules, a corporation must acquire all or substantially all of the resource properties of a person, and the corporation and the vendor must file an election. In addition, after June 3, 1987, the corporation must file an election after an amalgamation or winding-up to which the successor rules apply.

New subsection 66.7(8) of the Act sets out the corresponding rules relating to the acquisition of foreign resource properties.

ITA
66.7(9)

New subsection 66.7(9) of the Act replaces subsections 66.1(10) and (11) and provides special rules relating to the reclassification of a taxpayer's Canadian development expenses (CDE) under subsection 66.1(9) in circumstances where the successor rules apply to the expense. This subsection permits a successor corporation to reclassify unclaimed CDE of an original owner incurred after March, 1987 if the original owner would have been entitled to do so under subsection 66.1(9).

ITA
66.7(10)

New subsection 66.7(10) of the Act replaces subsection 66(11.1) and provides that the successor rule applies where control of a corporation has been acquired by another person or where a corporation ceases to be tax-exempt.

ITA
66.7(10)(a) to (e)

After the control or tax-exempt status change, the corporation is treated as a successor within the meaning of the successor rules (new sections 66.7(1) to (5) of the Act). The Canadian and foreign resource expenses incurred by it before the change shall (except for the purposes of subsection 66(12.71), dealing with the renunciation of flow-through share expenses) be treated as if they had been incurred by an original owner and not by the corporation. The deduction of these resource expenses by the successor is subject to the limitations of the successor rules.

ITA
66.7(10)(f)

Where one of the above changes occurs in the status of a corporation and, before the change, the corporation incurred foreign exploration and development expenses, new paragraph 66.7(10)(f) of the Act allows the corporation to designate, for the purposes of claiming a deduction in respect of those foreign expenses, a portion of its income for a subsequent year that is attributable to the production from the Canadian resource properties owned by it before the change. For the purposes of the successor rules in respect of Canadian resource properties and subparagraph 66.7(10)(g)(iii), income so designated will be treated as its income from foreign resource properties and not as income from the Canadian resource properties. The effect of this amendment is to allow a corporation after its change of status to deduct pre-change foreign exploration and development expenses to the extent of its Canadian resource property income so designated. The portion that may be designated for any year by the corporation cannot exceed the lesser of its

(a) income for the year attributable to the production from the Canadian resource properties owned by it before the change, and

(b) the amount by which 10 per cent of those undeducted foreign expenses incurred by it before the change exceeds its income for the year from foreign resource properties owned by it before the change.

ITA
66.7(10)(g)

Where the control or the tax-exempt status of a parent corporation changes at a time when the parent owns the Canadian resource property, and a subsidiary wholly-owned corporation of the parent (within the meaning of subsection 87(1.4) of the Act) had incurred Canadian resource expenses prior to the change, new paragraph 66.7(10)(g) allows the parent to designate in favour of the subsidiary any portion of its income for the year attributable to the production from such Canadian resource properties. Such a designation for a year may be made only where the subsidiary is a wholly-owned subsidiary of the parent throughout the year. After the designation, the amount designated will, for the purpose only of claiming a deduction under the new successor rules, be treated as production income of the subsidiary and not of the parent from Canadian properties owned by it prior to the change. For this provision to be effective, the subsidiary would need to have other sources of income to absorb the deduction of the Canadian resource expenses referred to above.

The parent and the subsidiary must agree to have this provision apply to them in respect of a taxation year of the parent ending after the change. The parent must notify the Minister of National Revenue in writing of the agreement in its return of income for the year.

The result of such a designation is to permit the subsidiary to deduct, in its taxation year in which the parent's taxation year ends, the Canadian resource expenses incurred by it before the change in status of the parent and while it was a subsidiary wholly-owned corporation of the parent, to the extent of the income so designated to it.

In the reverse situation, this paragraph allows the subsidiary to similarly designate amounts in favour of its parent.

ITA 66.7(10)(h)

Where the control or the tax-exempt status of a parent corporation changes at a time when the parent owns the foreign resource property, and a subsidiary wholly-owned corporation of the parent had incurred foreign resource expenses before the change, new paragraph 66.7(10)(h) allows the parent to designate in favour of the subsidiary any portion of its income for the year attributable to the production from such foreign resource properties. Such a designation for a year may be made only where the subsidiary is a wholly-owned subsidiary of the parent throughout the year. After the designation, the amount designated will, for the purpose only of claiming a deduction under the new successor rules, be treated as production income of the subsidiary and not of the parent from foreign properties owned by it before the change. For this provision to be effective, the subsidiary would need to have other sources of income to absorb the deduction of the foreign resource expenses referred to above.

The parent and the subsidiary must agree to have this provision apply to them in respect of a taxation year of the parent ending after the change. The parent must notify the Minister of National Revenue in writing of the agreement in its return of income for the year.

The result of such a designation is to permit the subsidiary to deduct, in its taxation year in which the parent's taxation year ends, the foreign resource expenses incurred by it before the change in status of the parent and while it was a subsidiary wholly-owned corporation of the parent, to the extent of the income so designated to it.

In the reverse situation, this paragraph allows the subsidiary to similarly designate amounts in favour of its parent.

ITA 66.7(10)(i)

Where, on the change of control or tax-exempt status of a parent, a subsidiary wholly-owned corporation of the parent owns the resource properties and another subsidiary wholly-owned corporation of the parent had incurred resource expenses before the change, new paragraph 66.7(10)(i) allows the subsidiary that owns the property to designate, in accordance with paragraphs (g) or (h), as the case may be, in favour of the other subsidiary a portion of its income attributable to the production from the properties owned by it immediately before the change of status.

ITA 66.7(10)(j)

Where, after January 15, 1987, the control or tax-exempt status of a corporation changes and at the time of either of those changes the corporation was a member of a partnership, new paragraph 66.7(10)(j) treats the corporation as owning, immediately before the change, a portion of the resource property owned by the partnership at the time of the change. The portion is equal to the corporation's percentage share of all amounts that would be paid to all members of the partnership if the partnership were wound up at the time of the change. In the event of a sale of these properties, the corporation would treat the proceeds as being from a disposition of resource properties owned before the change.

As a result of this new paragraph, the successor rules will permit the resource expenses of a corporation that is a member of a partnership that were incurred before a change of control or tax-exempt status of the corporation to be deducted by it to the extent of its share of the partnership income from resource properties owned at the time of change for a taxation year ending after the change. This share is the lesser of

(a) the corporation's share of the income of the partnership for the fiscal period of the partnership ending in the taxation year of the corporation that may reasonably be regarded as attributable to the production from the resource property of the partnership, and

(b) the corporation's share determined in (a) calculated on the basis of its share of income at the time of the change of status of the corporation.

ITA 66.7(11)

New subsection 66.7(11) of the Act is an anti-avoidance rule (announced on January 15, 1987) that applies where a taxpayer has disposed of all or substantially all of his Canadian or foreign resource properties or there has been a change of control of a corporate taxpayer. Where the taxpayer, or a partnership of which the taxpayer is a member, had previously acquired a Canadian or foreign resource property or an interest in a partnership and it may reasonably be considered that one of the main purposes of the acquisition was to avoid any limitation in the successor rules on the deductibility of any resource expenses, the anti-avoidance rule applies. The taxpayer is treated for the purposes of the successor rules as not having acquired the property. The effect of this will be to deny any deduction under the successor rules in respect of the property. This subsection is applicable with respect to acquisitions of property occurring after January 15, 1987 other than acquisitions of property occurring before 1988 where the persons acquiring the property were obliged on January 15, 1987 to acquire the property pursuant to agreements in writing entered into on or before that date.

ITA
66.7(13)

Where, after June 3, 1987, an original owner disposes of all or substantially all of his Canadian resource properties to a corporation in circumstances where the successor rules apply, new paragraphs 66.7(12)(a) and (e) provide that the resource expenses incurred by the original owner prior to the disposition shall, after the disposition, be treated as if they had not been incurred by him. Where the resource expenses so incurred are included in the original owner's cumulative Canadian resource expense pools, new paragraphs 66.7(12)(b), (c) and (d) of the Act provide that these pools shall be reduced to nil after the disposition. The effect of these rules is that the original owner is prevented from claiming a deduction of the resource expenses after the disposition of the properties in circumstances where a successor can claim the expenses.

ITA
66.7(14) and (15)

Subsection 66.7(13) of the Act deals with foreign resource expenses. It provides a similar rule to that described above for Canadian expenses. Where, after June 3, 1987, the original owner disposes of all or substantially all of his foreign resource properties and the successor rule applies, the expenses incurred by the original owner in respect of those properties are treated after the disposition as not having been incurred by him. The effect of this rule is that the original owner is prevented from claiming a deduction of these foreign resource expenses after the disposition of the properties in circumstances where a successor can claim the expenses.

ITA
66.7(14) and (15)

Subsections 66.7(14) and (15) of the Act provide rules for predecessor owners similar to those in subsections 66.7(12) and (13) applicable to original owners. Under subsection 66.7(14), where, after June 3, 1987, a predecessor owner of Canadian resource properties disposes of all or substantially all of its Canadian resource properties in circumstances in which the successor rules apply, it is treated after the disposition as never having acquired the properties in respect of which the successor rule applied. Under subsection 66.7(15), where after June 3, 1987, a predecessor owner of foreign resource properties disposes of all or substantially all of its foreign resource properties in circumstances in which the successor rules apply, it is treated after the disposition as never having acquired the properties in respect of which the successor rule applied. Thus, the predecessor owner is denied a deduction in respect of expenses that may be claimed by a successor.

ITA
66.7(16)

New subsection 66.7(16) of the Act provides that where a particular Canadian resource property or foreign resource property is acquired by a person in circumstances in which the successor rules do not apply, every person who was an original owner or predecessor owner of the property by reason of having previously disposed of the property shall, for the purposes of applying the successor rules to future owners of the property, be treated as never having been an original owner or predecessor owner of the property. Thus, the income from such properties thereafter will not qualify any expenses of a predecessor or original owner for a deduction in the hands of a successor.

Subclause 23(2)

Subclause (2) sets out the effective date for new section 66.7 of the Act. These provisions are generally applicable to taxation years ending after February 17, 1987. However, with respect to property acquired before January 15, 1987 or before 1988 pursuant to an agreement entered into on or before January 15, 1987, the reference to "production from the particular property" in subsections 66.7(1) to (5) shall be read as "where the particular property was an interest in or a right to take or remove petroleum or natural gas or a right to take or remove minerals from a property, the production from the property".

Anti-Avoidance Rule

Clause 24

ITA
69(11), (12) and (13)

New subsection 69(11) of the Act sets out an anti-avoidance rule which prevents a person or partnership from disposing of a property as part of a series of transactions for less than fair market value proceeds so as to obtain the benefit of the tax deductions or entitlements of a specified person on a subsequent disposition of the property. A "specified person" is defined by new subsection 69(12) as either a person that was not related to the vendor of the property or a partnership of which neither the vendor nor a person related to the vendor was a majority interest partner immediately before the series of transactions commenced. For this purpose, whether a person was related to the vendor is to be determined immediately before the series of transactions commenced and without reference to any right referred to in paragraph 251(5)(b) of the Act. "Majority interest partner" has the meaning assigned by amended subsection 97(3.1) of the Act – that is, where a taxpayer, his spouse and certain related persons either are entitled to more than 50 per cent of the partnership income for the partnership's fiscal period that includes the relevant time or would be entitled to more than 50 per cent of the partnership property if the partnership were to be wound up at that time.

Where subsection 69(11) applies, the vendor is considered to have disposed of the property for proceeds equal to its fair market value. Thus, the provision will apply where a taxpayer transfers property with an accrued profit to an unrelated corporation or partnership on a tax-free basis using a rollover provision in the Act so that upon a subsequent disposition of the property the corporation or partnership may shelter the accrued profit. For this purpose, a gain is considered to be sheltered where it is offset with a tax deduction or credit or where the proceeds are absorbed by any balance of undeducted expenditures – such as undepreciated capital cost in the case of depreciable property, unused R&D costs in the case of research properties, or the cumulative balances in the various resource expenditure pools in the case of mining and oil and gas properties. New subsections 69(11) and (12) apply to property that is disposed of after January 15, 1987, other than pursuant to an obligation on that date under an agreement in writing entered into on or before that date or as part of a series of transactions that commenced on or before that date.

New subsection 69(13) of the Act provides a special rule for the purpose of determining whether new subsection 69(11) is applicable in respect of amalgamations or mergers occurring after January 15, 1987. Generally, on an amalgamation or merger of two or more predecessor corporations to form a new corporation, the new corporation acquires the property of the predecessors on a rollover basis – that is, without any recognition by the predecessor corporations for tax purposes of any accrued gains or recaptured deductions in respect of the property. However, there may not technically be a disposition by the predecessor corporations of the property acquired by the new company. Since new subsection 69(11) applies only where there is a disposition of property, subsection 69(13) treats the property of a predecessor corporation as having been disposed of immediately before the amalgamation or merger for proceeds of disposition that reflect the rollover of the property to the new corporation. In the case of Canadian or foreign resource properties, the proceeds of disposition are nil. In the case of eligible capital property, the proceeds of disposition are twice the cost amount to the corporation of the property immediately before the amalgamation or merger. In the case of any other property, the proceeds of disposition are the cost amount to the corporation of the property immediately before the amalgamation or merger. The "cost amount" of property is defined in subsection 248(1) of the Act and means the undeducted cost of the property for tax purposes. The rule in subsection (13) is similar to the rule in paragraph 88(1)(a) of the Act that applies on the winding-up of a subsidiary corporation at least 90 per cent of whose shares are owned by its parent corporation.

Attribution Rules

Clause 25

ITA
74.1(1)

Subsection 74.1(1) of the Act provides that income from property transferred between spouses is treated for tax purposes as income of the transferor. The amendment to this subsection provides an exception to this rule where the property transferred is a right to receive a benefit from the Canada Pension Plan or a similar provincial plan. This is discussed in the commentary on subsection 56(2) of the Act. The amendment to subsection 74.1(1) is effective as of the initial effective date of the subsection.

Attribution Rules – Corporations

Clause 26

ITA
74.4(4)

Sections 74.1 to 74.5 of the Act provide attribution rules in respect of property transferred by an individual to a spouse or to another individual under the age of 18 years with whom he does not deal at arm's length. These rules, which were introduced as a result of the May 23, 1985 budget, are intended to prevent a taxpayer from splitting income among family members and thereby reducing the total amount of tax payable. Section 74.4 of the Act sets out the rules which apply where an individual loans or transfers property to a corporation, other than a small business corporation, for the benefit of a designated person – namely, the individual's spouse or a minor with whom he does not deal at arm's length. New subsection 74.4(4) is introduced to ensure that, in certain estate planning circumstances, section 74.4 will not apply with respect to a designated person who is the spouse or a non-arm's length minor in respect of an individual where the individual loans or transfers property to a corporation. The rule that imputes income to a transferor will not apply where the only interest which the designated person has in the corporation is a beneficial interest in the shares of the corporation which are held through a trust and the terms of the trust provide that the person may not receive or otherwise obtain the use of any income or capital of the trust while the person is a minor or is the spouse of the individual.

This amendment is applicable for the 1987 and subsequent taxation years, but only with respect to loans and transfers of property made after October 27, 1986.

Debtor's Gain on Settlement of Debts

Clause 27

ITA
80(1)(f)

Section 80 of the Act sets out the rules that apply where a debt owed by a taxpayer is settled or extinguished for less than its principal amount. In most circumstances, the resulting gain is not immediately taxable to the debtor but reduces, in turn, the amount of his deductible loss carry-overs from preceding taxation years, the capital cost of his depreciable property and the adjusted cost base of any other capital property. Paragraph 80(1)(f) provides that these rules do not apply where the gain is otherwise required to be included in computing the debtor's income for the year in which the debt is settled or extinguished or is required to be deducted in computing the capital cost to the debtor of any depreciable property or the adjusted cost base to him of any capital property.

The amendment to paragraph 80(1)(f) is consequential on an amendment to section 137.1 relating to deposit insurance corporations. An amendment to paragraph 137.1(10)(c) of the Act provides that the amount required to be included in the income of a member institution of a deposit insurance corporation, where the member institution's obligation to repay an amount to the deposit insurance corporation is settled or extinguished in a taxation year without full payment, does not include any amounts in respect of the indebtedness otherwise included in the member institution's income for the year or a preceding taxation year. The amendment to paragraph 80(1)(f) ensures that section 80 will not apply to such amounts that are excluded from income under paragraph 137.1(10)(c).

Paragraph 80(1)(f) is also amended to provide that the rules in section 80 also do not apply where the debtor's gain on settlement or extinguishment of a debt was otherwise required to be deducted in computing the cost amount to the debtor of any property other than capital property.

The amendments to paragraph 80(1)(f) are applicable to the 1983 and subsequent taxation years.

Share-for-Share Exchanges

Clause 28

Section 85.1 of the Act permits a tax-deferred rollover for shareholders who exchange shares of a corporation for shares of a Canadian purchaser corporation in the course of an arm's-length sale of the acquired corporation's shares. Under this rule, the shareholder's tax cost of the old shares becomes the tax cost of his new shares and any capital gain is deferred. In addition, the section provides that, in certain circumstances, the tax cost to the purchaser corporation of the shares of the acquired corporation will be increased to their fair market value. This increase in tax basis represents a departure from the ordinary rules relating to rollovers and can be used in ways that produce unintended results such as an unreasonable deferral of personal tax on capital gains, the avoidance of tax on corporate capital gains and the avoidance of tax payable on a corporate emigration under sections 88.1 and 219.1 of the Act.

Subclause 28(1)

ITA
85.1(1)

Subsection 85.1(1) of the Act is amended so that subsection 85.1 will apply only where the purchaser corporation issues shares of its capital stock that have not been previously issued in exchange for the taxpayer's shares of the acquired corporation. This amendment will apply to shares exchanged after June 3, 1987, other than shares exchanged after that date pursuant to an agreement in writing entered into on or before that date or pursuant to the terms of a prospectus, preliminary prospectus, proxy statement, preliminary proxy statement or registration statement filed with the appropriate securities authority in Canada or another country on or before that date.

Subclause 28(2)

ITA
85.1(1)(b)

Paragraph 85.1(1)(b) of the Act is amended to provide that, for shares acquired on a share-for-share exchange to which section 85.1 of the Act applies, the tax cost to the purchaser corporation of the shares so acquired will be the lesser of the fair market value of those shares and their paid-up capital immediately before the exchange. This amendment will apply to shares exchanged after February 17, 1987 other than shares exchanged after that date pursuant to an agreement in writing to do so entered into on or before that date or pursuant to the terms of a prospectus, preliminary prospectus, proxy statement, preliminary proxy statement or registration statement filed with the appropriate securities authority in Canada or another country on or before that date.

Subclause 28(3)

ITA 85.1(2.1)

New subsection 85.1(2.1) of the Act provides rules for computing the paid-up capital of the shares of a purchaser issued as a result of an exchange to which subsection 85.1(1) of the Act applies. New paragraph 85.1(2.1)(a) provides for a paid-up capital reduction equal to the amount by which the increase in the paid-up capital of all of the shares of the purchaser corporation as a result of the issue exceeds the paid-up capital of the exchanged shares received from the vendor. The paid-up capital reduction is allocated amongst those classes of shares that include the issued shares based on their legal paid-up capital increases. The purpose of this rule is to prevent the vendors from increasing, on an exchange, the paid-up capital of their shares that could otherwise be returned to the vendors without tax, and to prevent the avoidance of the effect of the amendment to paragraph 85.1(1)(b) through the use of a series of share exchanges. New paragraph 85.1(2.1)(b) of the Act provides for a paid-up capital addition where paragraph 85.1(2.1)(a) previously required a reduction of the paid-up capital of a class of shares. This addition will apply where subsection 84(3), (4) or (4.1) subsequently treats a dividend as having been paid by the corporation on shares of that class. The paid-up capital additions for a class of shares may not exceed the previous paid-up capital reductions for that class that resulted from the application of new paragraph 85.1(2.1)(a).

These amendments will apply to shares exchanged after June 3, 1987 other than shares exchanged after that date pursuant to an agreement in writing entered into on or before that date or pursuant to the terms of a prospectus, preliminary prospectus, proxy statement, preliminary proxy statement or registration statement filed with the appropriate securities authority in Canada or another country on or before that date.

Amalgamations

Clause 29

ITA 87

Section 87 of the Act deals with the tax treatment of the amalgamation of two or more taxable Canadian corporations.

Subclause 29(1)

ITA 87(1.2)

A new company formed as a result of an amalgamation can deduct the unclaimed exploration, development and resource property expenses of the predecessor corporation within the limits imposed by the successor rules. Subsection 87(1.2) of the Act provides an exception from the application of the successor rules. Where the predecessor corporations consist of a parent corporation and one or more of its subsidiary wholly-owned corporations, or where the predecessor corporations consist of two or more subsidiary wholly-owned corporations of the same parent corporation, subsection 87(1.2) allows the new corporation formed as a result of the amalgamation to deduct the exploration, development and resource property expenses of each of the predecessor corporations as if the new corporation were the same corporation as each of the predecessor corporations. Thus, the successor rules would not apply.

The amendment to subsection 87(1.2) of the Act adds a reference to new section 66.7 of the Act and is strictly consequential on the introduction of the new successor rules in section 66.7. This amendment is applicable to taxation years ending after February 17, 1987.

Subclause 29(2)

ITA
87(2)(e) and (e.1)

Paragraph 87(2)(e) of the Act treats the new corporation formed on an amalgamation of two or more predecessor corporations as having acquired all capital property, other than depreciable property, of each predecessor corporation at an amount equal to the adjusted cost base of the property to the predecessor corporation immediately before the amalgamation. Paragraph 87(2)(e) is amended to exclude an interest in a partnership from its application.

New paragraph 87(2)(e.1) is added to provide that the new corporation's cost of an interest in a partnership held by a predecessor corporation to which the new corporation was related is the cost of the interest to the predecessor corporation. It provides further that, with respect to that partnership interest, the new corporation is treated as the same corporation as, and a continuation of, the predecessor corporation which previously held the partnership interest. This ensures that all adjustments required to be made by the related predecessor corporation in calculating the adjusted cost base of its partnership interest will be taken into account in computing any gain or loss from a subsequent disposition of the partnership interest by the new corporation. Where the new corporation was not related to the predecessor corporation, new subsection 100(2.1) treats the predecessor corporation as having disposed of its partnership interest immediately before the amalgamation for proceeds equal to its adjusted cost base and treats the new corporation as having acquired that partnership interest at a cost equal to those proceeds. Subsection 251(3.1) of the Act treats a new corporation formed on an amalgamation as being related to a predecessor corporation where they would have been related immediately before the amalgamation if the new corporation had been in existence at that time with the same shareholders as after the amalgamation. New paragraph 87(2)(e.1) and the amendment to paragraph 87(2)(e) are applicable with respect to amalgamations occurring after January 15, 1987.

Subclause 29(3)

ITA
87(2)(j.3)

The amendment to paragraph 87(2)(j.3) is consequential on the introduction of the new provisions relating to retirement compensation arrangements

(RCAs). The amendment treats an amalgamated corporation as a continuation of its predecessors for the purpose of the new rules so that the new corporation formed on an amalgamation will be treated as having made contributions to any RCA to which contributions were previously made by any of the predecessor corporations. This rule, applicable after October 8, 1986, also applies for the purposes of the rules in section 88 of the Act relating to the winding-up of a subsidiary into a parent corporation.

Subclause 29(4)

ITA
87(2)(j.6)

Paragraph 87(2)(j.6) of the Act ensures that the rules in certain provisions of the Act that applied to a predecessor corporation that has later amalgamated continue to apply to the amalgamated corporation as they would if the amalgamated corporation were the same corporation as, and a continuation of, the predecessor corporation. The provisions of this paragraph also apply with appropriate modifications to a winding-up of a taxable Canadian corporation pursuant to subsection 88(1) of the Act.

The amendment to paragraph 87(2)(j.6) adds new subsections 13(24), 66(11.4) and 66.7(11) to the list of provisions covered by the continuation rule. As a result of this amendment, the rules in new subsections 13(24), 66(11.4) and 66.7(11), which apply where a depreciable or resource property has been acquired by a corporation before a change of control (or before the disposition of all or substantially all of the corporation's Canadian or foreign resource properties), cannot be circumvented by arranging for an amalgamation or winding-up of the corporation between the time of the property acquisition and the time of the change of control (or the time of the disposition). This amendment is applicable with respect to amalgamations occurring after January 15, 1987.

Subclause 29(5)

ITA
87(2)(j.8)

New paragraph 87(2)(j.8) of the Act is consequential on the introduction of the international banking centre business provisions contained in new section 33.1. This paragraph ensures that the provisions contained in section 33.1 will continue to apply to an amalgamated corporation as they would have if the amalgamated corporation were the same corporation as, and a continuation of, its predecessor corporations. The provisions of new paragraph 87(2)(j.8) also apply pursuant to paragraph 88(1)(e.2) of the Act for the purposes of the rules relating to the winding-up of a subsidiary into its parent corporation. New paragraph 87(2)(j.8) applies to taxation years beginning after the day on which the enabling legislation receives Royal Assent.

Subclause 29(6)

ITA
87(2)(x)

Existing paragraph 87(2)(x) provides a rule for the purposes of subsections 112(3) and (4) where there has been an amalgamation of two or more predecessor corporations to form a new corporation. Subsection 112(3) of the Act provides what is generally referred to as a "stop-loss" rule. This rule reduces a corporation's loss on the sale of a share by the amount of tax-free dividends received on the share. These dividends are either taxable dividends that were deductible by the corporation under section 112 or subsection 138(6) of the Act, capital dividends or life insurance capital dividends. Subsections 112(3.1) and (3.2) extend the stop-loss rule to the loss of a corporation with respect to shares held by a partnership or trust of which it is a partner or beneficiary. Subsection 112(4) is the equivalent of the subsection 112(3) stop-loss rule in the case of losses on shares that are not capital property of the taxpayer and subsection 112(4.1) provides that any tax-free dividends received must be added to the fair market value of such shares when computing their value for inventory purposes. Subsections 112(4.2) and (4.3) extend this rule to a loss arising with respect to shares held by a partnership or trust that are not capital property.

The rule under paragraph 87(2)(x) treats any taxable dividend received by the predecessor corporation on a share and deductible by it under section 112 as having been received by the new corporation and deductible by it under section 112. As a result, the stop-loss rules in subsections 112(3) and (4) take such dividends into account on a disposition of the share after the amalgamation. Paragraph 87(2)(x) is amended with respect to amalgamations occurring after June 3, 1987 so that it applies also for the purposes of the rules in subsections 112(3.1), (3.2), (4.1), (4.2) and (4.3) and with respect to dividends received by a predecessor corporation that were tax-free because they were deductible under subsection 138(6) of the Act or because they were capital dividends or life insurance capital dividends. The amended paragraph treats dividends received by a predecessor as having been received by the new corporation with the same characterization as they had for the predecessor corporation. As a result, such dividends will be taken into account in the application of the stop-loss rules on a disposition of the share after the amalgamation. Paragraph 88(1)(e.2) of the Act provides that the rule in paragraph 87(2)(x) also applies, with appropriate modifications, for the purposes of the rules relating to the winding-up of a subsidiary corporation into its parent corporation.

Subclause 29(7)

ITA
87(2.1)(b)

Subsection 87(2.1) of the Act permits an amalgamated corporation to deduct the unclaimed non-capital losses, net capital losses, restricted farm losses, farm losses and limited partnership losses of its predecessor corporations, subject to the same limitations in subsections 111(3) to (5.4) of the Act that would apply if the amalgamated corporation were the same corporation as, and a continuation of, the predecessor corporations. The amendment to paragraph 87(2.1)(b) adds a reference to new paragraph 149(10)(d). As a result, the restriction in new paragraph 149(10)(d) on the carry-forward of losses after a corporation becomes, or ceases to be, exempt from tax under Part I of the Act will continue to apply after an amalgamation of the corporation. This amendment is applicable with respect to amalgamations occurring after June 3, 1987.

Winding-Up of a Corporation

Clause 30

ITA
88(1) and (1.1)

Subsections 88(1) and (1.1) of the Act set out detailed rules relating to the winding-up of a taxable Canadian corporation into a parent corporation that owns at least 90 per cent of its shares.

Subclause 30(1)

ITA
88(1)

Subsection 88(1) of the Act treats the property of a subsidiary corporation that is distributed to its parent corporation on a winding-up of the subsidiary as having been disposed of by the subsidiary for proceeds of disposition that generally result in a tax-free transfer or "rollover" of the property to the parent corporation. Existing subsection 88(1) applies notwithstanding any other provision of the Act. The opening words of the subsection are amended, applicable after January 15, 1987, to make the subsection apply notwithstanding any other provision of the Act other than new subsection 69(11). As a result, the rollover of property on a winding-up of a subsidiary into its parent may be denied where the anti-avoidance rule in new subsection 69(11) applies with respect to the property disposition that subsection 88(1) treats as having occurred. Where subsection 69(11) applies, the property would be treated as having been disposed of at fair market value.

Subclauses 30(2) to (5)

ITA
88(1)(a), (a.2), (c) and (e.2)

The amendments to paragraphs 88(1)(a), (c) and (e.2) and the introduction of new paragraph 88(1)(a.2) provide for the cost and cost base adjustments of a partnership interest distributed by a subsidiary corporation to its parent corporation on a winding-up of the subsidiary corporation to flow through to the parent corporation. Thus, these adjustments are to be taken into account in computing any gain or loss from a subsequent disposition of the partnership interest by the parent corporation. These changes are applicable with respect to windings-up commencing after January 15, 1987. A subsidiary corporation's partnership interest distributed to its parent corporation on a winding-up of the subsidiary will no longer be treated as having been disposed of before the winding-up. As a result, any excess of negative cost base adjustments for the partnership interest over the aggregate of the subsidiary's cost of the partnership interest and positive cost base adjustments for the partnership interest that would, before these amendments, have been required to be recognized as a capital gain immediately before the winding-up will now not be required to be recognized until the parent corporation disposes of the partnership interest.

Technically, these amendments are as follows:

- Paragraph 88(1)(a), which treats each property of a subsidiary as having been disposed of for specified proceeds of disposition, is amended so as not to apply to an interest in a partnership.
- New paragraph 88(1)(a.2) treats each partnership interest distributed to a parent corporation on a winding-up of its subsidiary corporation as not having been disposed of by the subsidiary corporation.
- Paragraph 88(1)(c) provides that the cost to a parent corporation of capital property distributed to it on the winding-up of its subsidiary corporation is the amount treated by paragraph (a) as being the subsidiary corporation's proceeds of disposition of the property plus, in some circumstances, an additional amount as determined under paragraph (d). Paragraph (c) is amended to provide that where the property is an interest in a partnership, the amount determined under paragraph (d), if any, that is required to be added in computing the cost to the parent of the partnership interest shall be added to the cost to the parent as otherwise determined, which would be the cost of the partnership interest to its subsidiary corporation.
- Paragraph 88(1)(e.2) makes certain rules in section 87 of the Act dealing with amalgamations apply with any necessary modifications to the winding-up of a subsidiary corporation. The paragraph is amended to include a reference to new paragraph 87(2)(e.1) so that the rule in that new paragraph will apply on a winding-up. As a result, the cost to a parent corporation of a partnership interest distributed to it on a winding-up of its subsidiary will be the amount that was the cost of the interest to the subsidiary, and with respect to that partnership interest the parent corporation will be treated as the same corporation as, and a continuation of, the subsidiary. This ensures that all adjustments required to be made in computing the adjusted cost base to the subsidiary of the partnership interest will be taken into account in computing any gain or loss from a subsequent disposition of the partnership interest by the parent corporation.

Subclauses 30(6) and (7)

ITA
88(1)(e.3)

Paragraph 88(1)(e.3) of the Act provides for the flow-through of investment tax credits from a subsidiary corporation to a parent corporation on a winding-up of the subsidiary. Subparagraph 88(1)(e.3)(i) is amended to allow the parent corporation to include in the calculation of its investment tax credit, the amount of such credit that was allocated to the subsidiary by a trust or a partnership as if the amount had been allocated to the parent corporation in the year that it was allocated to the subsidiary.

Where the subsidiary corporation has experienced a change of control prior to the winding-up, paragraph 88(1)(e.3), as currently structured, limits the investment tax credits of the subsidiary corporation earned before the change of control which can be flowed through to the parent without allowing the parent to "earn back" those investment tax credits which have been so limited. Subparagraph 88(1)(e.3)(ii) is amended to allow the parent to reinstate investment tax credits, which have been restricted as a result of a change of control of the subsidiary, to the extent that, after the change of control, the parent has generated a federal income tax liability in respect of income arising from the same business or a business similar to that in which the subsidiary earned those credits.

These amendments generally apply to windings-up commencing after May 23, 1985. However, in respect of acquisitions of control of a subsidiary occurring after January 15, 1987 (other than acquisitions of control occurring before 1988 where the persons acquiring the control were obliged on January 15, 1987 to acquire the control pursuant to an agreement in writing entered into on or before that date) the parent may not earn back the investment tax credits of the subsidiary by virtue of any taxable capital gain arising as a result of the disposition of property which was formerly that of the subsidiary.

Subclause 30(8)

ITA
88(1.1)

Subsection 88(1.1) of the Act permits the flow-through to a parent corporation of the non-capital losses, restricted farm losses and farm losses of a subsidiary corporation which has been wound up where the parent owned at least 90 per cent of the subsidiary's issued shares. This provision was amended as a consequence of the introduction of the provisions relating to limited partnership losses in order to permit the flow-through to a parent corporation of the limited partnership losses of a subsidiary following a winding-up. However, a reference to paragraph 111(1)(e), which provides for the deductibility of accumulated limited partnership losses in certain circumstances, was inadvertently omitted from the part of subsection 88(1.1) between paragraphs (b) and (c) thereof. Subsection 88(1.1) is amended to incorporate this reference applicable after February 25, 1986.

Subclause 30(9)

ITA
88(1.1)(e)

Existing paragraph 88(1.1)(e) of the Act provides that where control of a parent or subsidiary corporation has been acquired, any non-capital losses or farm losses incurred by the subsidiary from carrying on a business before the change of control may be deducted by the parent following the winding-up of the subsidiary only if that business is carried on throughout the year in which the loss is sought to be claimed. Where this condition is met, the losses may be deducted to the extent of the parent's income for the year from that business and any similar business and the parent's net taxable capital gains from dispositions of certain property owned by the subsidiary at the time of the change of control.

The amendments to paragraph 88(1.1)(e) parallel amendments made to subsection 111(5) of the Act. The opening words of existing paragraph 88(1.1)(e) provide that the paragraph applies where control of a corporation is acquired by a person or persons. The words "person or persons" are changed to read "person or group of persons". This makes the terminology consistent with terminology used elsewhere in the Act relating to control. The opening words are also amended to provide that no amount in respect of a subsidiary's non-capital loss or farm loss for a taxation year ending before the time of an acquisition of control of the parent or subsidiary is deductible in computing the parent's taxable income for a particular taxation year ending after that time except to the extent that the conditions in subparagraphs (i) and (ii) are met. As a result of this amendment, the subsidiary's losses from property and allowable business investment losses incurred before the acquisition of control may no longer be carried forward to be deducted by the parent after the acquisition of control.

The amendment to paragraph 88(1.1)(e) also applies to restrict the deduction in respect of a subsidiary's non-capital losses and farm losses for its taxation year that is treated by new subsection 249(4) as having ended immediately before the acquisition of control.

Subparagraph 88(1.1)(e)(ii) is also amended to deny the deductibility of a subsidiary's non-capital losses and farm losses incurred before an acquisition of control of the subsidiary or parent against the parent's net taxable gains from dispositions of property owned by the subsidiary at the time of the change of control.

The amendments to paragraph 88(1.1)(e) are applicable to acquisitions of control occurring after January 15, 1987 other than those occurring before 1988 where the persons acquiring the control were obliged on January 15, 1987, to acquire the control pursuant to agreements in writing entered into on or before that date.

Subclause 30(10)

ITA
88(1.5)

Where there has been a winding-up of a subsidiary into a parent corporation that owned at least 90 per cent of the subsidiary's shares, subsection 88(1.5) of the Act provides that the parent is considered to be the same corporation as the subsidiary for the purpose of the provisions of the Act dealing with the deduction of exploration, development and resource property expenses. This effectively removes the restrictions of the successor corporation rules that would otherwise apply with respect to the deduction by the parent of the unclaimed resource expenses of the subsidiary following its winding-up.

The amendment to subsection 88(1.5) of the Act adds a reference to new subsection 66.7 of the Act and is strictly consequential on the introduction of the new successor rules in section 66.7. This amendment is applicable to taxation years ending after February 17, 1987.

"Paid-Up Capital" Definition

Clause 31

ITA
89(1)(c)(ii)(C)

Subparagraph 89(1)(c)(ii) of the Act defines "paid-up capital" in respect of a class of the shares of the capital stock of a corporation. Clause (C) thereof provides that, after March 31, 1977, paid-up capital is calculated without reference to any provision of the Act other than those specified therein. The amendment to this clause simply adds references to subsection 66.3(4) and new subsection 85.1(2.1) and is consequential on the addition of those provisions to the Act. This amendment is applicable after February 17, 1987.

Partnership Income

Clause 32

ITA
96(1)(d)

Under subsection 96(1) of the Act, the income earned and losses incurred by a partnership are generally calculated at the partnership level and attributed to partners in accordance with their respective interests. However, paragraph 96(1)(d) provides that the income or loss of a partnership is computed without reference to the disposition of resource properties or the deduction of exploration, development and resource property expenses. These items are included in computing the income or loss of the individual partners.

Paragraph 96(1)(d) contains a reference that subsection 30(1) of the *Income Tax Application Rules, 1971* (ITARs) defines as a reference to section 29 of the ITARs. Paragraph 96(1)(d) is amended, effective for taxation years ending after February 17, 1987, to refer directly to section 29 of the ITARs.

This amendment is applicable to taxation years ending after February 17, 1987.

Majority Interest Partner

Clause 33

ITA
97(3.1)

Subsection 97(3.1) of the Act defines "majority interest partner" for the purposes of subsection 97(3), which denies a deduction for a capital loss realized by a majority interest partner of a partnership on the transfer of property to the partnership. A taxpayer is considered to be a majority interest partner of a partnership immediately after the disposition of property to the partnership if the taxpayer, his spouse and certain related persons either are entitled to more than 50 per cent of the partnership income for the partnership's fiscal period in which the property was disposed of to the partnership or would be entitled to more than 50 per cent of the partnership property if the partnership were to be wound up immediately after the disposition of the property to the partnership.

This definition is amended, applicable after January 15, 1987, to treat a taxpayer as a majority interest partner of a partnership at any time if the taxpayer, his spouse and certain related persons either are entitled to more than 50 per cent of the partnership income for the partnership's fiscal period that includes that time or would be entitled to more than 50 per cent of the partnership property if the partnership were to be wound up at that time. The purpose of this change is not to alter the definition but simply to allow it to be adopted for the purposes of the new rules introduced in subsections 13(24), 69(12) and 107(6) of the Act.

Disposition of an Interest in a Partnership

Clause 34

ITA
100(2.1)

New subsection 100(2.1) of the Act applies where an amalgamation or merger occurs after January 15, 1987 and the new corporation formed on the amalgamation or merger acquires an interest in a partnership from a predecessor corporation to which it was not related. Subsection 251(3.1) of the Act treats a new corporation formed on an amalgamation or merger as being related to a predecessor corporation if they would have been related immediately before the amalgamation or merger if the new corporation had been in existence at that time with the same shareholders as after the amalgamation or merger. Under new subsection 100(2.1), an unrelated predecessor is treated as having disposed of its interest in the partnership to the new corporation immediately before the amalgamation or merger for proceeds of disposition equal to its adjusted cost base, and the new corporation is treated as having acquired the interest immediately after that time at a cost equal to the amount of such proceeds. As a result of this change, the predecessor corporation will be required under existing subsection 100(2) to recognize a gain on the disposition of any interest in the partnership which had a negative adjusted cost base. The gain is measured as the excess of amounts required by subsection 53(2) of the Act to be deducted in computing the adjusted cost base of the predecessor's partnership interest over the total of its cost of the interest and all amounts required by subsection 53(1) to be added in computing the adjusted cost base of its interest. The negative adjusted cost base of a partnership interest held by a predecessor corporation that is related to the newly amalgamated corporation is preserved on the amalgamation under the rules set out in new paragraph 87(2)(e.1) of the Act.

Loss on Property Previously Owned by a Trust

Clause 35

ITA
107(6)

New subsection 107(6) of the Act is an anti-avoidance rule designed to discourage a taxpayer from acquiring a capital interest in a trust that has a property with an accrued loss so the property can be distributed to the taxpayer in satisfaction of such interest at the cost amount of the property to the trust. Without this rule, the accrued loss could be realized by the taxpayer on a subsequent disposition of the property and used to shelter his other income from taxation. The rule reduces the taxpayer's loss on the subsequent disposition by the portion of the loss that may reasonably be considered to have accrued during a period in which the property was owned by the trust and a capital interest in the trust was not owned by the taxpayer, a person related to the taxpayer or a partnership of which the taxpayer or a person related to the taxpayer was a majority interest partner. For this purpose, "majority interest partner" has the meaning assigned by amended subsection 97(3.1) of the Act. (Under that definition, a taxpayer is a majority interest partner of a partnership at any time if the taxpayer, his spouse and certain related persons either are entitled to more than 50 per cent of the partnership income for the partnership's fiscal period that includes that time or would be entitled to more than 50 per cent of the partnership property if the partnership were to be wound up at that time.) New subsection 107(6) is applicable with respect to property distributed to a beneficiary from a trust in satisfaction of all or part of a capital interest in the trust that was acquired by the beneficiary after January 15, 1987 otherwise than pursuant to an obligation on that date under an agreement in writing entered into on or before that date.

Distribution by a Retirement Compensation Arrangement

Clause 36

ITA
107.2

New section 107.2, applicable after October 8, 1986, provides rules to deal with a distribution by a trust governed by a retirement compensation arrangement. The rules require the trust to recognize a gain or loss when it distributes trust property to a beneficiary by treating the trust as having disposed of the property at its then fair market value. The recipient, who may not be the taxpayer required to include the amount of the distribution in income, is considered to acquire the property at that fair market value.

The beneficiary is also considered to have disposed of his interest in the trust that is satisfied by the distribution for proceeds equal to his adjusted cost base of that interest so that he has neither a gain nor loss from the transaction. If the beneficiary had a cost for the interest as a result of making contributions to the arrangement or of buying the interest, such costs will be deductible under paragraph 60(t) or (u).

Finally, if depreciable property is involved in the distribution the beneficiary will, on disposition of the property, be liable to include in his income any recovery of capital cost allowance that was previously claimed by the trust.

Trust Definitions

Clause 37

Section 108 of the Act sets out certain definitions for the purposes of the provisions relating to trusts.

Subclauses 37(1) and (2)

ITA
108(1)(c) and (e)

Paragraph 108(1)(c) of the Act defines the "capital interest" of a taxpayer in a trust and paragraph 108(1)(e) of the Act defines the "income interest" of a taxpayer in a trust.

The definition of a "capital interest" in a trust is amended as a consequence of the amendment, described below, to the definition of an "income interest" in a trust. As amended, a "capital interest" is any right of a taxpayer as a beneficiary to, or to receive capital under a testamentary trust or an *inter-vivos* trust in which none of the beneficial interests were purchased from the trust or a settlor thereof and any right of a taxpayer under any other *inter-vivos* trust. Thus, where any interest in an *inter-vivos* trust is purchased from the trust or a settlor of the trust, all interests in the trust will be treated as capital interests for the purposes of the Act. This amendment avoids the unintended result that may be obtained on the disposition of an interest in an investment trust under the former definitions, where the interest of a taxpayer could be regarded as two properties – an income interest and a capital interest. Under the amended definition, an interest in an investment trust will constitute a capital interest and the cost thereof will be taken into account in determining any gain or loss on the disposition of such an interest.

The definition of an "income interest" in a trust is amended so that the only trusts in which there can be income interests are what might be referred to as "family trusts" – that is, testamentary trusts and *inter-vivos* trusts in which none of the interests is purchased from the trust or a settlor thereof. This amendment will limit the deduction available under subsection 106(1) to the cost of income interests in these family trusts. As described above, an interest of a taxpayer as a beneficiary under a trust which does not constitute an income interest is treated as a capital interest, and as a result the cost of such interest is taken into account in determining any gain or loss on its disposition.

The amendments to the definitions of "capital interest" and "income interest" apply in respect of interests which have been created or materially altered after January 31, 1987 and acquired after 10:00 p.m. E.S.T. on February 6, 1987.

Subclauses 37(3) and (4)

ITA
108(1)(j)

There are two amendments to the definition of "trust" in paragraph 108(1)(j) of the Act. One of the amendments, which is applicable after October 8, 1986, is consequential on the introduction of the new rules relating to retirement compensation arrangements. The amendment adds an "RCA trust" to the list of trusts that are excluded from certain of the ordinary rules governing the taxation of trusts. Thus, the 21-year deemed realization, preferred beneficiary and capital distribution rollover provisions do not apply to an "RCA trust". New subsection 207.5(1) contains the definition of an

"RCA trust" and reference may be made to the commentary under that provision.

The other amendment to paragraph 108(1)(j), which is applicable to the 1987 and subsequent taxation years, is consequential on the introduction of new paragraph 149(1)(o.4) relating to master trusts. The amendment provides that a master trust that is exempt from tax under Part I of the Act as the result of an election under new paragraph 149(1)(o.4) is excluded from the definition of "trust" in paragraph 108(1)(j). The result is that the special rules in subsections 104(4), (5), (12), (14) and (15) and sections 105 to 107 of the Act do not apply to master trusts.

Deductions in Computing Taxable Income

Clause 38

Section 110 of the Act provides for a number of deductions in computing taxable income.

Subclause 38(1)

ITA
110(1)(d)

Paragraph 110(1)(d) of the Act provides for a deduction in computing taxable income where certain employee stock options are exercised. The amendment to this paragraph is strictly technical. It ensures that the paragraph applies as intended where the taxpayer has disposed of, rather than exercised, his stock option. This amendment is generally applicable after May 22, 1985 when paragraph 110(1)(d) was last amended.

Subclause 38(2)

ITA
110(1)(j)

Subsection 80.4(1) of the Act requires the benefit received by a taxpayer as the result of a low-interest employer loan to be included in income. Paragraph 110(1)(j) provides for an offsetting deduction from taxable income where the benefit is in respect of a home relocation loan. Subparagraph 110(1)(j)(i) is amended so that the deduction available under that subparagraph parallels the income inclusion provided in respect of such loans in subsection 80.4(1).

Also, subparagraph 110(1)(j)(ii) limits the deduction available for a home relocation loan to the equivalent benefit which would be derived from a five-year, interest-free loan of $25,000. This subparagraph is amended to refer to "the home relocation loan" instead of "a home relocation loan" in order to incorporate the other terms and conditions, if any, of the particular home relocation loan.

These amendments are applicable to the 1985 and subsequent taxation years.

Pension Income Deduction

Clause 39

ITA
110.2(4)

Subsection 110.2(4) of the Act lists the types of pension and retirement-related income which do not qualify for the pension income deduction. For the 1987 and subsequent taxation years, new paragraph 110.2(4)(h) adds payments out of a prescribed provincial pension plan to the list of non-qualifying payments. These are provincial plans to which contributions are deductible under the new rules introduced in paragraph 60(v) of the Act.

Restrictions on Loss Carry-Overs

Clause 40

ITA
111

Under subsection 111(1) of the Act, a taxpayer may carry over losses of one taxation year for deduction in computing its taxable income in other taxation years. This carry-over is denied or restricted under subsections 111(4) to (5.2) in the case of a corporation which has undergone a change of control. The amendments to section 111 extend these restrictions and introduce other rules that apply where there has been an acquisition of control of a corporation.

Subclause 40(1)

ITA
111(4)

Subsection 111(4) of the Act provides that where control of a corporation is acquired by a person or persons, the corporation's net capital losses for taxation years preceding the acquisition of control may not be carried forward to taxation years ending after the acquisition, and its net capital losses for taxation years following the acquisition may not be carried back to taxation years commencing before the acquisition. The words "person or persons" at the beginning of the subsection are changed to read "person or group of persons". This makes the terminology consistent with terminology used elsewhere in the Act relating to control. New paragraphs 111(4)(a) and (b) preserve the existing rules. Paragraphs 111(4)(c) to (e) add new rules that apply where control of a corporation is acquired and the corporation neither becomes nor ceases to be exempt from tax under Part I of the Act at the time control is acquired.

New paragraph 111(4)(c) requires the adjusted cost base of each capital property, other than depreciable property, owned by a corporation immediately before the time of an acquisition of control of the corporation, to be reduced at and after that time by the excess immediately before that time of the property's adjusted cost base over its fair market value. New paragraph 111(4)(d) treats this excess as a capital loss of the corporation from the disposition of the property for the taxation year that is treated by new subsection 249(4) of the Act as having ended immediately before the acquisition of control.

New paragraph 111(4)(e) of the Act provides that, where control of a corporation is acquired, the corporation may treat such of its capital properties as it chooses (other than a property to which paragraph (c) applies) as having been disposed of by it immediately before the end of the taxation year ending immediately before the time of the acquisition of control. The proceeds of disposition for such a property may be any amount not less than its adjusted cost base and not greater than its fair market value. The corporation is treated as having reacquired the properties at the time of the acquisition of control at a cost equal to those proceeds of disposition, except where the property is depreciable property. In this case, new paragraph 13(7)(f) treats the capital cost of the property to the corporation at the time of the reacquisition, for the purposes of the capital cost allowance and recapture rules, as being half-way between the capital cost of the property before the disposition and the proceeds of disposition. The choice of properties and their proceeds of disposition must be designated by the corporation in its return of income for the year ending immediately before the acquisition of control. A designation may be made later, or an earlier designation may be amended, in a prescribed form filed with Revenue Canada, Taxation on or before the day that is 90 days after the date of mailing of a notice of tax payable for that year or a notification that no tax is payable for that year. A corporation would generally want to take advantage of the new rule in paragraph 111(4)(e) to realize capital gains that could be offset by capital losses of the corporation for pre-acquisition taxation years.

For the purposes of the non-arm's length exception to the half-year capital cost allowance convention in subsection 1100(2.2) of the *Income Tax Regulations*, a corporation that is treated as having reacquired a depreciable property as a result of a paragraph 111(4)(e) election will be considered not to be dealing with itself at arm's length.

The amendments to subsection 111(4) apply with respect to acquisitions of control occurring after January 15, 1987 other than those occurring before 1988 where the persons acquiring the control were obliged on January 15, 1987 to acquire the control pursuant to agreements in writing entered into on or before that date.

Subclauses 40(2), (3) and (4)

ITA
111(5)

Subsection 111(5) of the Act provides that where control of a corporation has been acquired, its non-capital losses and farm 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. Also, its non-capital losses and farm 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 if similar conditions are met.

The words "person or persons" at the beginning of subsection 111(5) are changed to read "person or group of persons". This makes the terminology consistent with that used elsewhere in the Act relating to control and is not intended to cause any change in meaning. The opening words of subsection

111(5) are also amended to provide that, except as provided by paragraphs (5)(a) and (b), no amount in respect of a non-capital loss or farm loss of a corporation for a taxation year ending before the time of an acquisition of control is deductible for a taxation year ending after that time, and no amount in respect of any such loss for a taxation year ending after that time is deductible for a taxation year ending before that time. As a result of this amendment, a loss from property or allowable business investment loss incurred by a corporation before the time of an acquisition of its control may no longer be carried forward as a non-capital loss to be deducted after that time. In addition, a loss from property or allowable business investment loss incurred by the corporation after that time may no longer be carried back as a non-capital loss to be deducted in a taxation year ending before a change of control.

The amendments also restrict the deduction in respect of a corporation's non-capital losses and farm losses for its taxation year that is treated by new subsection 249(4) as having ended immediately before the time of the acquisition of control. The restricted carry-back of capital losses and farm losses is also extended to the carry-back of such losses for a corporation's taxation year that is treated as having commenced at the time when the corporation's control was acquired. These changes apply where control of a corporation is acquired part way through its fiscal period. Thus, a non-capital loss or farm loss incurred in carrying on a business during that part of a corporation's fiscal period that is before the acquisition of control is deductible for the taxation year that is the remainder of the fiscal period or for any subsequent year only where that business is carried on throughout that year and only to the extent of the corporation's income from that business and any similar business. The carry-back of a non-capital loss or farm loss of the corporation incurred in carrying on a business in the remainder of the fiscal period is similarly restricted.

Paragraph 111(5)(a) is also amended to deny the deductibility of non-capital losses and farm losses incurred by a corporation before an acquisition of its control against any taxable capital gains for a taxation year ending after the acquisition.

The amendments to subsection 111(5) are applicable with respect to acquisitions of control occurring after January 15, 1987 other than acquisitions of control occurring before 1988 where the persons acquiring the control were obliged on January 15, 1987 to acquire the control pursuant to the terms of agreements in writing entered into on or before that date.

Subclause 40(5)

ITA
111(5.1), (5.2) and (5.3)

Existing subsection 111(5.1) of the Act 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 the fair market value of the property 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 or farm loss of the corporation for the taxation year immediately preceding the year in which control was acquired.

The words "person or persons" at the beginning of subsection 111(5.1) are changed to read "person or group of persons". This makes the terminology consistent with that used elsewhere in the Act relating to control and is not intended to cause any change of meaning.

Existing subsection 111(5.1) does not apply on the change of control of a corporation that was exempt from tax under Part I of the Act immediately before the control change. This exception is amended so that the subsection does not apply on the change of control of a corporation that either becomes, or ceases to be, exempt from tax under Part I of the Act at the time of the control change. For the rules that apply on a change of the tax-exempt status of a corporation, see the commentary on subsection 149(10) of the Act.

Amended subsection 111(5.1) applies where there is an acquisition of control of a corporation and the undepreciated capital cost of all its property of a prescribed class (determined without regard to the rule in new subsection 13(24) that in some cases postpones the addition of the cost of recently acquired property to the capital cost allowance classes until immediately after the time of the change of control) immediately before the acquisition of control exceeds the total of:

- its fair market value at that time,

- the capital cost allowance taken by the corporation in respect of that class in computing its income for the taxation year that is treated by new subsection 249(4) as having ended at that time, and

- any amount deducted in that year as a terminal loss in respect of property of that class.

That excess is required to be deducted in computing the corporation's income for the year immediately preceding the change of control and the deduction is treated as having been claimed as capital cost allowance. As a result, the excess either reduces the income or increases the non-capital loss or farm loss of the corporation for that year and is not available to be deducted in later years except under the loss carry-forward rules as set out in subsections 111(1) and (5).

This amendment is applicable with respect to acquisitions of control occurring after January 15, 1987 other than acquisitions of control occurring before 1988 where the persons acquiring the control were obliged on January 15, 1987 to acquire the control pursuant to agreements in writing entered into on or before that date.

Existing subsection 111(5.2) of the Act provides that where control of a corporation has been acquired in a taxation year, the amount by which its cumulative eligible capital in respect of a business exceeds one-half of the fair market value of the eligible capital property in respect of the business is treated as having been deducted by the corporation in computing its income in previous taxation years. This amount is treated as a non-capital loss or farm loss of the corporation for the taxation year immediately preceding the year in which control was acquired.

The words "person or persons" at the beginning of subsection 111(5.2) are changed to read "person or group of persons". This makes the terminology consistent with that used elsewhere in the Act relating to control and is not intended to cause any change of meaning.

Existing subsection 111(5.2) does not apply on the change of control of a corporation that was exempt from tax under Part I of the Act immediately before the control change. This exception is amended so that the subsection does not apply on the change of control of a corporation that either becomes, or ceases to be, exempt from tax under Part I of the Act at the time of the control change.

Amended subsection 111(5.2) applies where there is an acquisition of control of a corporation and its cumulative eligible capital in respect of a business immediately before the acquisition of control exceeds the total of:

- the amount deducted by the corporation under paragraph 20(1)(b) of the Act in computing its income for the taxation year that is treated by new subsection 249(4) as having ended at that time, and

- one-half of the fair market value at that time of its eligible capital property in respect of the business.

That excess is required to be deducted by the corporation under paragraph 20(1)(b) of the Act in computing its income for the year immediately preceding the change of control. As a result, the excess either reduces the income or increases the non-capital loss or farm loss of the corporation for that year and is not available to be deducted in later years except under the loss carry-forward rules as set out in subsections 111(1) and (5).

This amendment is applicable with respect to acquisitions of control occurring after January 15, 1987 other than acquisitions of control occurring before 1988 where the persons acquiring the control were obliged on that date to acquire the control pursuant to agreements in writing entered into on or before that date.

Existing subsection 111(5.3) of the Act provides a special rule for the purposes of existing subsections 111(5.1) and (5.2) to deal with the circumstances where control of a corporation is acquired in its first taxation year.

As a consequence of the amendments to subsections 111(5.1) and (5.2), this rule is no longer necessary and is repealed.

New subsection 111(5.3) of the Act applies where control of a corporation is acquired by a person or group of persons and the corporation does not become, or cease to be, exempt from tax under Part I of the Act at that time. Where the subsection applies, no amount may be deducted under paragraph 20(1)(l) of the Act as a reserve for doubtful debts in computing the corporation's income for its taxation year that is treated by new subsection 249(4) as having ended immediately before the acquisition of control. Any amount that would have been deductible by the corporation on account of a doubtful debt owed to it immediately before the acquisition of control, if it were allowed a doubtful debt deduction, is treated by subsection 111(5.3) as a separate debt. This separate debt is, notwithstanding any other provision of the Act, required to be deducted as a bad debt under paragraph 20(1)(p) of the Act in computing the corporation's income for the year ending immediately before the acquisition of control. Any amount received by the corporation with respect to this separate debt in a subsequent taxation year will be required by paragraph 12(1)(i) of the Act to be included in computing the corporation's income for that subsequent year. The excess of the amount of the debt over the amount of that separate debt is itself treated as a separate debt incurred at the same time and under the same circumstances as the debt was incurred.

The repeal of existing subsection 111(5.3) and the introduction of new subsection 111(5.3) are applicable with respect to acquisitions of control occurring after January 15, 1987 other than acquisitions of control occurring before 1988 where the persons acquiring the control were obliged on January 15, 1987 to acquire the control pursuant to agreements in writing entered into on or before that date.

Subclause 40(6)

ITA 111(5.5)

New subsection 111(5.5) of the Act is an anti-avoidance rule which provides that where the main reason for the acquisition of control of a corporation is to trigger the recognition of accrued losses of the corporation under paragraph 111(4)(d) or subsection 111(5.1), (5.2) or (5.3), those provisions and paragraphs 111(4)(c) and (e) will not be applicable. This rule would apply, for example, where the controlling shareholder of a corporation disposes of his shares to another person and reacquires them in an attempt to have the corporation's accrued losses realized for tax purposes. While accrued losses may not be claimed in such cases, other rules in the Act governing the tax treatment of a corporation which has undergone a change of control would be applicable such as new subsection 249(4), which treats the corporation's taxation year as having ended immediately before the change of control, and paragraphs 111(4)(a) and (b) and subsection 111(5) which restrict the carryover of a corporation's losses where its control has been acquired.

New subsection 111(5.5) is applicable with respect to acquisitions of control occurring after January 15, 1987 other than acquisitions of control occurring before 1988 where the persons acquiring control were obliged on January 15, 1987 to acquire control pursuant to the terms of agreements in writing entered into on or before that date.

Subclause 40(7)

ITA
111(8)(a)(ii)

Paragraph 111(8)(a) of the Act defines the "net capital loss" of a taxpayer for a taxation year. Certain capital losses realized on the sale of shares or other securities of a small business corporation are treated separately as business investment losses. Any such losses that cannot be deducted in the year they arise are treated as non-capital losses that may be carried back three years and forward seven years. Net capital losses, however, may be carried forward indefinitely. Subparagraph 111(8)(a)(ii) provides that where a taxpayer's allowable business investment loss for a year is included in his non-capital loss that would expire in the seventh year of the carry-forward period, the allowable business investment loss is to be included in the taxpayer's net capital loss for that future year. As a result, allowable business investment losses which cannot be deducted in the carry-forward period for non-capital losses may be carried forward indefinitely as net capital losses. Subparagraph 111(8)(a)(ii) is amended to provide that where the taxpayer is a corporation that has undergone a change of control during the seven year carry-forward period, the loss may not be included in the corporation's net capital loss. This result is consistent with the provisions that do not allow an allowable business investment loss to be carried forward for deduction after a change of control as a non-capital loss. The amendment to subparagraph 111(8)(a)(ii) is applicable with respect to the 1987 and subsequent taxation years.

Intercorporate Dividends

Clause 41

ITA
112(2.4) to (2.9)

Section 112 of the Act is the principal provision dealing with the treatment for tax purposes of dividends received by one taxable Canadian corporation from another.

Subsection 112(1) of the Act permits a corporation to deduct taxable dividends in computing its taxable income. There are, however, several exceptions to this rule. For example, subsection 112(2.1) prevents a "specified financial institution" from deducting taxable dividends received on term preferred shares acquired in the ordinary course of its business. Subject to certain exceptions, subsection 112(2.2) also denies the intercorporate dividend deduction where a specified financial institution (other than the issuer) has undertaken to guarantee or insure the shareholder's investment or return. New subsection 112(2.4) will, after November 27, 1986 and subject to transitional relief described below, prevent a corporation from deducting a taxable dividend received on so-called collateralized preferred shares. These shares have been issued by corporations with accumulated losses and deductions in order to provide a means of sheltering the income of profitable corporations from tax.

In the absence of new subsection 112(2.4), a profitable corporation earning income that would ordinarily be subject to full rates of tax (e.g., interest income on Treasury bills) could transfer the Treasury bills to a loss corporation in consideration for the issue of preferred shares. The result is that the interest income would be earned by the loss corporation. Since no tax would be paid on this income, the pre-tax yield on the Treasury bills, less a commission or administrative charge payable to the loss corporation for the use of its losses, could be distributed to the profitable corporation as a taxable dividend on the preferred shares. Provided this dividend is deductible under subsections 112(1) or (2) or 138(6) of the Act, no tax is paid on the income earned by the profitable corporation notwithstanding the fact that in substance it represents interest income earned on the Treasury bills.

In effect, through the use of preferred shares, the loss corporation's tax deductions have been transferred indirectly to the profitable corporation. New subsection 112(2.4) will, subject to several limitations, deny the intercorporate dividend deduction in these situations. These limitations narrow the focus of new subsection 112(2.4) so that it will not apply to most ordinary share issues.

The first limitation is that new subsection 112(2.4) will apply only to transactions that are designed to enable the transfer of losses or deductions as between corporations. This limitation, contained in new subsection 112(2.5), provides that new subsection 112(2.4) will apply to deny the deduction for an intercorporate dividend only where the share on which the dividend is paid was issued or acquired as part of a transaction or series of transactions that enable a corporation to earn investment income or income substituted therefor (such as income arising under a swap contract) in circumstances where the corporation can use tax deductions to reduce or eliminate the tax that would otherwise be payable on that income. Thus, new subsection 112(2.4) may apply in the example noted above if the loss corporation can use losses, capital cost allowance claims or investment tax credits that would not otherwise be utilized but for the acquisition of the Treasury bills and the issue of the preferred shares. On the other hand, because of this limitation a share of a profitable taxable corporation would not normally be subject to new subsection 112(2.4). This limitation also ensures that subsection 112(2.4) will not apply if the share proceeds are used in the ordinary course of an active business carried on by the loss corporation rather than to earn investment income.

The second limitation is that new subsection 112(2.4) will apply only where the transactions are structured in such a way that the profitable corporation's share interest in the loss corporation is secured. This security feature is the basis for the term "collateralized preferred share". This security may take several forms. First, there may be some form of undertaking that protects the profitable corporation's share interest in the loss corporation from loss. If such an undertaking exists, new paragraph 112(2.4)(a) will apply. For example, the loss corporation may place the proceeds of the share issue in a trust which guarantees the repurchase or redemption of the preferred shares and purchases Treasury bills to secure its guarantee. In this situation the profitable corporation is, in effect, in the same position as if it had invested in the Treasury bills directly. To ensure that the tax consequences are the same in these two situations, the intercorporate dividend deduction will be denied.

Under new subsection 112(2.8), a profitable corporation's share interest in a loss corporation will be considered to be protected from loss where the undertaking insures the profitable corporation's investment in any other share, debt or obligation of the loss corporation and this other investment was acquired or issued in conjunction with the issue or acquisition of the first-mentioned share. For example, a profitable corporation could transfer Treasury bills to a loss corporation in consideration for the issue of a class of shares while, at the same time, subscribing for a second class of shares for a nominal amount. Dividends would subsequently be paid on the second class of shares but the undertaking which insures the profitable corporation's investment relates to the first class of shares. In this case new subsection 112(2.4) will apply even though the undertaking does not relate to the shares on which dividends are paid.

A second approach to securing the profitable corporation's share interest is for the profitable corporation to retain control or possession of the share proceeds. New paragraph 112(2.4)(b) will apply in these circumstances. For example, rather than investing the share proceeds in a trust which provides an undertaking to protect the profitable corporation from loss, the loss corporation may simply reloan the funds either to the profitable corporation or to a person who does not deal at arm's length with the profitable corporation. It should be noted that a deduction will not be denied under new subsection 112(2.4) if the obligation referred to in new subparagraph 112(2.4)(b)(i) is issued by a corporation that is related, otherwise than by virtue of a right referred to in paragraph 251(5)(b), to the corporation which issued the subject share. New subsection 112(2.9) will prevent corporations from becoming related simply for the purpose of sheltering under the exception to this application of subsection 112(2.4). The specific exemption from new subparagraph 112(2.4)(b)(i) will ensure that transfers of losses and deductions between related corporations will not be affected by these new provisions.

New paragraph 112(2.4)(b) also applies if the proceeds of the share issue constitute an income interest which may revert to the profitable corporation at its discretion. Thus, where the profitable corporation retains control over the income source which has been transferred to the loss corporation as a means of providing security for the share investment, the intercorporate dividend deduction will be denied if the income source is acquired by the loss corporation in conjunction with the acquisition by the profitable corporation of the shares of the loss corporation.

Under new subsection 112(2.4) the corporation receiving the dividend is referred to as the "particular corporation" and the corporation paying the dividend is referred to as the "other corporation". New subsection 112(2.6) provides expanded definitions of these terms for the purposes of new subsection 112(2.4). The definition of "investor" includes the particular corporation and any person with whom the particular corporation does not deal at arm's length (but not including the other corporation), or a partnership or trust of which either the particular corporation or a person with whom the particular corporation does not deal at arm's length is a member or beneficiary. Similarly the definition of "issuer" means the other corporation and a person with whom the other corporation does not deal at arm's length (other than the particular corporation) or a partnership or trust of which either the other corporation or a person with whom the other corporation does not deal at arm's length is a member or beneficiary. These expanded definitions are necessary to ensure that the provisions of new subsection 112(2.4) are not avoided through the use of other members of a corporate group.

New subsection 112(2.6) also includes a definition of "exempt share" which ensures that new subsection 112(2.4) will not apply to shares issued before 5 p.m. Eastern Standard Time, November 27, 1986 – the date on which the new rules relating to collateralized preferred shares were made public. However, an "exempt share" excludes a share held at that time either by the issuer or by any other person or partnership in circumstances where the issuer may become entitled to receive after that time any amount that relates to the share by way of subscription proceeds or contribution of capital pursuant to an agreement made before that time. For this purpose, new subsection 112(2.7) provides that where at any time there is any change in the terms or conditions of a share of the capital stock of a corporation, or an agreement has been entered into with respect to the share by the corporation, the share will be considered to have been issued at that time. As a consequence, the share would lose its exempt status and would be subject to new subsection 112(2.4) if all the other conditions of that subsection are met. The purpose of this rule is to ensure that the provisions of subsection 112(2.4) cannot be avoided simply by using a previously issued share.

Disposition of Property by Non-Residents

Clause 42

ITA
115.1

Paragraph 8 of Article XIII of the Canada-United States Tax Convention (1980) provides a mechanism designed to avoid the occurrence of double taxation where, as a result of a corporate organization, reorganization, amalgamation, division or similar transaction, a taxpayer that is a resident of one of the Contracting States disposes of property on a tax-deferred basis in that Contracting State but is subject to tax on the disposition under the taxation laws of the other Contracting State. In these circumstances, the Convention provides that the other Contracting State may agree to defer the taxation of the resultant income or gain to the time when such income or gain is eventually taxed by the Contracting State where the taxpayer resides. Double taxation might otherwise occur if each Contracting State levies tax in different taxation years and the taxpayer is not able to make proper use of his foreign tax credits.

Although the Canada-United States Convention has been in force since August 16, 1984, the tax deferral permitted by paragraph XIII (8) has not been accommodated by the adoption of a provision of the *Income Tax Act* permitting the tax deferral. New section 115.1 will permit a tax deferral and maintain the tax base in Canada where a transaction described in paragraph XIII (8) of the Canada-United States Convention has tax-deferred status in the U.S. but does not have this status in Canada. This new section will also accommodate similar provisions which, although not in force at this time, have been included in Canada's tax treaties with France and the Netherlands or that will be included in future tax treaties.

New section 115.1 applies where a non-resident person is otherwise subject to tax in Canada on a disposition of property in Canada but the Minister of National Revenue has agreed to defer tax on the disposition pursuant to a prescribed tax treaty provision. It is proposed to prescribe paragraph XIII (8) of the Canada-United States Tax Convention (1980) for this purpose. The new provision is intended to apply to a case such as the following:

> A U.S. corporation (A) holds all the shares in another U.S. corporation (B). Corporations A and B are resident only in the U.S., however, B holds real property situated in Canada. B is wound up into A, resulting in a disposition under the Canadian Income Tax Act of the real property. Under U.S. tax law, the liquidation is on a tax-free basis.

To avoid the immediate taxation in Canada of the disposal of the real estate as a result of the winding-up, paragraph XIII(8) of the Canada-United States Tax Convention (1980) provides that A, as the acquirer of the property, may request that the Minister of National Revenue agree to defer Canadian tax on any resultant income or gain. For this purpose, new section 115.1 stipulates that, where the parties (A and B in the example) have jointly filed the appropriate election, the amount contained in the election and agreed upon by the Minister shall be deemed to be the vendor's (B's) proceeds of disposition of the property and the purchaser's (A's) cost of the property. Where the property is depreciable property, paragraph 115.1(d) preserves its tax base in Canada. Paragraph 115.1(e) maintains the characterization of the property in Canada. Thus, in all cases, Canada's tax base is protected.

New section 115.1 is applicable to taxation years commencing after 1984.

Tax Payable by Individuals

Clause 43

ITA
117(6)

Subsection 117(6) of the Act provides the authority for the use of a tax table to assist individual taxpayers to determine their tax payable. Under existing law, such a table may only be used to calculate a taxpayer's ordinary tax liability under Part I of the Act. This subsection is amended to include a reference to the surtax which is imposed under Part I.1 of the Act so that taxpayers may use the table to calculate their total liability for income tax for the 1986 and subsequent taxation years.

Federal Sales Tax Credit

Clause 44

ITA
122.4

Section 122.4 of the Act provides a refundable federal sales tax credit for "eligible individuals" and their "qualified relations". Both of these terms are defined in subsection 122.4(1).

Subclause 44(1)

ITA
122.4(1)(b)

The definition of "qualified relation" of an individual for a taxation year set out in paragraph 122.4(1)(b) is amended, for the 1987 and subsequent years, to ensure that a person is a "qualified relation" of only one eligible individual for a taxation year. This is achieved by stipulating that a person can be a "qualified relation" of an individual only if no other individual is claiming a refundable federal sales tax credit in respect of that person.

Subclause 44(2)

ITA
122.4(3)(d)

Subsection 122.4(3) of the Act provides a refundable sales tax credit of $50 to an "eligible individual" and $25 for each "qualified relation" of the individual. This amount is reduced by five cents for each dollar of family income in excess of $15,000. Paragraph 122.4(3)(d) is amended for the 1987 and subsequent years so that, for the purposes of this $15,000 threshold, the income for the year of the parents (where they live together) and that of a parent and of any other person who claims a personal exemption in respect of one or more of their children must be aggregated.

Foreign Tax Credit

Clause 45

Section 126 of the Act sets out the rules relating to the foreign tax credit.

Subclauses 45(1) and (2)

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

Section 126 of the Act permits a taxpayer to claim a foreign tax credit. Subsection 126(1) sets out the rules for determining the amount of credit permitted in respect of foreign non-business income tax – that is, foreign taxes levied on investment income and other foreign-source income other than business income. A foreign tax credit for foreign taxes on foreign-source business income is provided under subsection 126(2).

Neither foreign tax 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 taxpayer's foreign income to his total income. Total income for the purposes of this ratio is the aggregate of the taxpayer's income for a taxation year and any amount added to taxable income under section 110.5 (in respect of foreign tax deductions) minus certain deductions claimed by the taxpayer in computing taxable income. The existing formula allows the total income to be reduced below the amount added under section 110.5. This represents a technical deficiency that produces an incorrect determination of the appropriate foreign tax credit.

The amendments to subparagraphs 126(1)(b)(ii) and (2.1)(a)(ii) correct this deficiency by providing that, in computing total income for purposes of the foreign tax credit for the 1985 and subsequent taxation years, the amount claimed by a taxpayer under section 110.5 is to be added after taking into account taxable income deductions.

Subclause 45(3)

ITA
126(7)(c)(viii)

Paragraph 126(7)(c) of the Act defines the "non-business-income tax" paid by a taxpayer for a taxation year to the government of a country other than Canada, for the purpose of determining the taxpayer's foreign tax credit. New subparagraph 126(7)(c)(viii) reduces a taxpayer's non-business-income tax by the amount of any foreign tax that may reasonably be regarded as attributable to any interest or other amount received or receivable by the taxpayer in respect of a loan for the period in the year during which it was an eligible loan of an international banking centre business. The purpose of this provision is to exclude any foreign tax paid by a taxpayer on loans the income from which is eligible for exclusion in computing taxable income under new section 33.1 as income from an international banking centre business. New subparagraph 126(7)(c)(viii) applies with respect to taxation years beginning after the date on which the enabling legislation receives Royal Assent.

Investment Tax Credit

Clause 46

Subsections 127(6) to (12.3) of the Act provide rules for determining the investment tax credit of a taxpayer.

Subclause 46(1)

ITA
127(9)

The Act provides for a three-year carry-back and a seven-year carry-forward of unused investment tax credits earned in a taxation year. Paragraph (j) of the definition "investment tax credit" in subsection 127(9) limits the amount by which a corporation may carry forward unused investment tax credits earned before a change of its control. Paragraph (k) of the definition limits the amount by which a corporation may carry back unused investment tax credits earned after a change of its control. These paragraphs are amended to refer to situations where control of a corporation is acquired "by a person or group of persons" rather than "by a person or persons". These amendments are consistent with the amendments to subsections 127(9.1) and (9.2), which set out the rules for calculating the limitations for the purposes of paragraphs (j) and (k). The same changes are reflected in the new rules relating to loss carry-overs on a change of control of a corporation, as described in the commentary on subsection 111(5). These amendments are applicable with respect to acquisitions of control occurring after January 15, 1987 other than acquisitions of control occurring before 1988 where the persons acquiring the control were obliged on January 15, 1987 to acquire the control pursuant to the terms of agreements in writing entered into on or before that date.

Subclauses 46(2) to (7)

ITA
127(9.1) and (9.2)

Subsection 127(9.1) of the Act sets out the rules for determining the amount by which a corporation's carry-forward of unused investment tax credits earned before a change of control is limited, under paragraph (j) of the definition of "investment tax credit", for claims against taxes payable in respect of income earned after the change of control. Subsection 127(9.2) sets out the rules for determining the amount by which a corporation's carry-back of unused investment tax credits earned after a change of control is limited, under paragraph (k) of the definition of "investment tax credit", for claims made against taxes payable in respect of income earned before the change of control.

The preamble of subsection 127(9.1) of the Act is amended to refer to situations where control of a corporation is acquired "by a person or group of persons". This amendment is consistent with the new rules relating to loss carry-overs on a change of control of a corporation, as described in the commentary on subsection 111(5). This amendment is applicable with respect to acquisitions of control occurring after January 15, 1987 other than acquisitions of control occurring before 1988 where the persons acquiring the control were obliged on January 15, 1987 to acquire the control pursuant to the terms of agreements in writing entered into on or before that date.

Paragraph 127(9.1)(b) of the Act allows a corporation to reduce the amount by which the carry-forward of its investment tax credits has been limited following a change of control by an amount equal to the portion of its refundable investment tax credit for the year in which the change of control occurred that relates to acquisitions of property and eligible expenditures made before the change of control. Because new subsection 249(4) treats a corporation as having a year-end immediately before its control is acquired, this time period has been eliminated. Accordingly, this paragraph is no longer necessary and it is repealed.

This amendment is applicable with respect to acquisitions of control occurring after January 15, 1987 other than acquisitions of control occurring before 1988 where the persons acquiring the control were obliged on January 15, 1987 to acquire the control pursuant to the terms of agreements in writing entered into on or before that date. However, for acquisitions of control occurring after April, 1986 and before January 16, 1987 or before 1988 pursuant to an agreement in writing entered into on or before January 15, 1987, the references to "May 1, 1986" in paragraph 127(9.1)(b) are to be read as "January 1, 1989".

Paragraph 127(9.1)(d) of the Act allows a corporation to apply unused investment tax credits earned by it before a change of control to offset that portion of its federal income tax liability for periods after the change of control that is attributable to income from the same business or a similar business as that in respect of which the investment tax credits were earned. Subparagraph 127(9.1)(d)(ii) provides the rules applicable to income earned in that portion of the year in which the change of control occurs that is before the change of control. This period has been eliminated as a result of the introduction of new subsection 249(4) which treats a corporation as having a year-end immediately before its control is acquired. Accordingly, subparagraph 127(9.1)(d)(ii) is no longer necessary and it is repealed.

Paragraph 127(9.1)(d) of the Act is also amended, for the purpose of the rule that permits any investment tax credit that was limited on a change of control to be re-established as a result of tax arising in respect of income generated by the same or a similar business as that in which the credit was earned. The amendment provides that such income cannot be taken into account in a year if it has been offset by a loss carry-over from those businesses from another year. Paragraph 127(9.1)(d) is also amended to provide that, for these purposes, no account is to be taken of taxable capital gains arising from dispositions of properties that were used in those businesses before the change of control. This amendment is consequential to, and consistent with, the introduction of the new loss rules and, particularly, the amendments to subsection 111(5). This amendment is applicable with respect to acquisitions of control occurring after January 15, 1987 other than acquisitions of control occurring before 1988 where the persons acquiring the control were obliged on January 15, 1987 to acquire the control pursuant to the terms of agreements in writing entered into on or before that date. However, the provisions offsetting income from a particular business against loss carry-overs from that business from other years, for the purposes of re-establishing investment tax credits which have been limited as a result of a change of control, are applicable only in respect of changes of control occurring after June 3, 1987.

The preamble of subsection 127(9.2) of the Act is amended to refer to circumstances in which control of a corporation is acquired "by a person or group of persons". This amendment is consequential to the introduction of the new loss rules as described in the commentary on subsection 111(5). This amendment is applicable with respect to acquisitions of control occurring after January 15, 1987 other than acquisitions of control occurring before 1988 where the persons acquiring the control were obliged on January 15, 1987 to acquire the control pursuant to the terms of agreements in writing entered into on or before that date.

Paragraph 127(9.2)(b) of the Act allows a corporation to reduce the amount by which the carry-back of its investment tax credits is limited following a change of control by an amount equal to the portion of its refundable investment tax credit for the year in which the change of control occurred that relates to acquisitions of property and eligible expenditures made after the change of control. Because new subsection 249(4) treats a corporation as having a year-end immediately before its control is acquired, this time period has been eliminated. Accordingly, this paragraph is no longer necessary and it is repealed.

This amendment is applicable with respect to acquisitions of control occurring after January 15, 1987 other than acquisitions of control occurring before 1988 where the persons acquiring the control were obliged on January 15, 1987 to acquire the control pursuant to the terms of agreements in writing entered into on or before that date. However, for acquisitions of control occurring after April, 1986 and before January 16, 1987 or before 1988 pursuant to an agreement in writing entered into on or before January 15, 1987, the references to "May 1, 1986" in paragraph 127(9.2)(b) are to be read as "January 1, 1989".

Paragraph 127(9.2)(d) of the Act allows a corporation to apply unused investment tax credits earned by it after a change of control to offset that portion of its federal income tax liability for periods before the change of control that is attributable to income from the same business or a similar business as that in respect of which the investment tax credits were earned. Subparagraph 127(9.2)(d)(i) provides the rules applicable to income earned in that portion of the year in which the change of control occurs that is before the change of control. This period has been eliminated as a result of the introduction of new subsection 249(4) which treats a corporation as having a year-end immediately before control of the corporation is acquired. Accordingly, subparagraph 127(9.2)(d)(i) is no longer necessary and it is repealed.

Paragraph 127(9.2)(d) of the Act is also amended, for the purpose of the rule that permits any investment tax credit that was limited on a change of control to be re-established as a result of tax arising in respect of income generated by the same or a similar business as that in which the credit was earned. The amendment provides that such income cannot be taken into account in a year if it has been offset by a loss carry-over from those businesses from another year. This amendment is consequential to, and consistent with, the amendments to section 111 of the Act relating to losses.

The amendments to paragraph 127(9.2)(d) are applicable with respect to acquisitions of control occurring after January 15, 1987 other than acquisitions of control occurring before 1988 where the persons acquiring the control were obliged on January 15, 1987 to acquire the control pursuant to the terms of agreements in writing entered into on or before that date. However, the provisions offsetting income from a particular business against loss carry-overs from that business from other years, for the purposes of re-establishing investment tax credits which have been limited as a result of a change of control, are applicable only in respect of changes of control occurring after June 3, 1987.

Subclause 46(8)

ITA
127(10)(c)

Subsection 127(10) of the Act provides that the Minister of National Revenue may obtain advice from the Minister of Regional Industrial Expansion in determining whether a property is "certified property" for the purpose of the 40 per cent special investment tax credit. This subsection is amended to provide that the Minister of National Revenue may also give advice to the Minister of Regional Industrial Expansion to assist that Minister in making a determination as to whether any property is prescribed property for the purposes of the 60 per cent Cape Breton investment tax credit. This amendment is effective after June 3, 1987.

Patronage Dividends

Clause 47

ITA
135(2) and (2.1)

Where a taxpayer such as a cooperative has, in a taxation year, made payments pursuant to allocations in proportion to patronage to his member and non-member customers at different rates, subsection 135(2) of the Act currently restricts the deduction the taxpayer may claim in a taxation year in respect of such payments made to member customers. This deduction is limited in any year to the lesser of the payments made by the taxpayer to member customers during the taxation year and its income for the year attributable to business done with its member customers. Where the patronage payments made to member customers in a taxation year under those circumstances exceed this limit, the excess payment may not be deducted in any other year.

The amendment to subsection 135(2) of the Act is consequential on the introduction of the special provision contained in new subsection 135(2.1) to allow the carry-over of the excess patronage dividend payment. This amendment provides that the subsection 135(2) limitation applies only with respect to the deduction which may be taken in the year under subsection 135(1) in respect of payments made pursuant to allocations in proportion to patronage within the year or within 12 months thereafter.

New subsection 135(2.1) of the Act provides that where, in a preceding taxation year ending after 1985, a taxpayer made payments pursuant to allocations in proportion to patronage to member customers in excess of the limitation imposed by subsection 135(2), the undeducted excess payment will be deductible against the income of the taxpayer for a subsequent taxation year attributable to business done by him with member customers of that year. This deduction will be permitted to the extent that the taxpayer's income for the subsequent year attributable to business done with member customers of that year exceeds the amount deducted by the taxpayer in that year by virtue of subsection 135(1) in respect of payments made pursuant to allocations in proportion to patronage to member customers of that year.

In order to illustrate the effect of the amendment to subsection 135(2) and the introduction of new subsection 135(2.1), the following example is provided.

Example

- A taxpayer that is a cooperative earns $100,000 of income for the year.
- Income for the year attributable to business done with member customers is $60,000.
- The taxpayer makes allocations in proportion to patronage at different rates to member and non-member customers and as a result the subsection 135(2) limitation applies.
- The taxpayer overestimates the income attributable to business done with member customers and makes payments pursuant to allocations in proportion to patronage to member customers totalling $75,000.
- The taxpayer makes payments pursuant to allocations in proportion to patronage to non-member customers totalling $25,000.

Given the above assumptions, subsection 135(2) will limit the deduction for the payments made by the taxpayer to all customers pursuant to allocations in proportion to patronage to the aggregate of the $25,000 paid to non-member customers and $60,000 – that is, the lesser of the taxpayer's income for the year attributable to business done with member customers of $60,000 and the payments made by the taxpayer to the member customers of $75,000. Therefore, the deduction permitted under subsection 135(1) will be $85,000. Prior to the introduction of new subsection 135(2.1) and the amendment to subsection 135(2), the excess payment of $15,000 could not be deducted in any year.

New subsection 135(2.1) will permit the deduction of the $15,000 excess payment in a subsequent taxation year. However, the deduction will be restricted to the lesser of two amounts. The first amount is the undeducted balance of the $15,000 excess.

The second amount is the excess of the taxpayer's income for that subsequent taxation year attributable to business done with member customers of that year over the deduction made under subsection 135(1) for that subsequent year in respect of payments made pursuant to allocations in proportion to patronage to member customers of that year. For example, if in the subsequent year, the income attributable to business done with member customers was $75,000 and the taxpayer made payments pursuant to allocations in proportion to patronage to member customers of that year of $70,000, then $5,000 of the previous year's excess could be deducted by virtue of new subsection 135(2.1). The remaining $10,000 could be carried forward to subsequent years.

Cooperative Corporations

Clause 48

ITA
136(2)(c)

Paragraph 136(2)(c) of the Act provides that for a corporation to qualify as a cooperative corporation under the Act, at least 90 per cent of its members must be individuals or other cooperative corporations, and at least 90 per cent of its shares must be held by such persons. This amendment, applicable for the 1987 and subsequent taxation years, adds corporations or partnerships that carry on the business of farming to the members of a cooperative corporation that are eligible for the purposes of meeting the 90 per cent membership and share ownership conditions.

Deposit Insurance Corporations

Clause 49

ITA
137.1

Section 137.1 of the Act sets out special rules relating to the taxation of deposit insurance corporations and their member institutions. Generally, these rules provide that premiums paid by a member institution to a deposit insurance corporation may be deducted in computing the member institution's income but are not required to be included in computing the deposit insurance corporation's income. Further, any assistance provided by a deposit insurance corporation to a member institution or a depositor or member of the member institution may not be deducted by the deposit insurance corporation in computing its income but is required to be included in computing the member institution's income. Deposit insurance corporations, however, are taxable on their other sources of income.

Subclauses 49(1) and (2)

ITA
137.1(3)(e)(iii) and (f)

Subsection 137.1(3) of the Act lists a number of deductions available to a deposit insurance corporation in computing its income for a taxation year. There are two additions to this list.

The addition of new subparagraph 137.1(3)(e)(iii) allows a deposit insurance corporation a deduction for the 1980 and subsequent taxation years for expenses incurred in supervising or administering a member institution in financial difficulty.

The addition of new paragraph (3)(f) allows a deduction in computing income for the 1980 and subsequent taxation years for interest (including compound interest) paid in the year by a deposit insurance corporation pursuant to a legal obligation on borrowed money used:

- to lend money to or otherwise assist a member institution in financial difficulty,
- to assist in the payment of losses suffered by members or depositors of a member institution in financial difficulty,
- to lend money to the deposit insurance corporation's subsidiary wholly-owned corporation that is treated by new subsection 137.1(5.1) as being a deposit insurance corporation, or
- to acquire property from a member institution in financial difficulty.

Subclause 49(3)

ITA
137.1(5)(c)(iv)

For a corporation to qualify as a "deposit insurance corporation" under section 137.1 of the Act, at least 50 per cent of its property must constitute "investment property". For this purpose, paragraph 137.1(5)(c) of the Act defines "investment property" as being certain debts issued or guaranteed by governments, deposits or guaranteed investment certificates with a bank or trust company, and money. New subparagraph (c)(iv) includes in this definition the investments of a deposit insurance corporation in the shares or debt of a subsidiary wholly-owned corporation that is treated by new subsection 137.1(5.1) as a deposit insurance corporation. Where such a subsidiary invests in another subsidiary wholly-owned corporation, subparagraph (iv) does not apply to consider that investment to be investment property. New subparagraph (iv) is applicable to the 1985 and subsequent taxation years.

Subclause 49(4)

ITA
137.1(5.1)

New subsection 137.1(5.1) of the Act permits a subsidiary wholly-owned corporation of a deposit insurance corporation described in paragraph 137.1(5)(a) to be treated as a deposit insurance corporation for the 1985 and subsequent taxation years where it meets a condition concerning its investments. This condition is that all or substantially all of the subsidiary's property since its incorporation must have consisted of property qualifying as investment property for deposit insurance corporations, shares or debt obligations of a member institution of the deposit insurance corporation obtained by the subsidiary when the member institution was in financial difficulty, or property acquired from the member institution at a time when the member institution was in financial difficulty. Where the subsidiary meets this condition, any member institution of the deposit insurance corporation is treated as a member institution of the subsidiary. "Subsidiary wholly-owned corporation" is defined in subsection 248(1) of the Act as a corporation all the issued share capital of which, other than directors' qualifying shares, belongs to the corporation to which it is subsidiary.

New subsection 137.1(5.1) applies for the purposes of section 137.1 other than

- subsection (2) which provides that premiums received or receivable by a deposit insurance corporation from its member institutions shall not be included in computing the deposit insurance corporation's income,
- paragraph (3)(d) which allows a deposit insurance corporation a deduction for expenses incurred in collecting premiums from its member institutions,
- subparagraph (3)(e)(i) which allows a deposit insurance corporation a deduction for expenses incurred when acting as a curator of a bank or a liquidator or receiver of a member institution,
- subsection (9) which applies a 25 per cent tax rate to deposit insurance corporations other than the Canada Deposit Insurance Corporation, and
- subsection (11) which allows member institutions a deduction for premiums paid or payable to a deposit insurance corporation.

Subclause 49(5)

ITA
137.1(10) and (10.1)

Paragraphs 137.1(10)(a) and (b) of the Act require a member institution to include in computing its income for a taxation year any assistance provided in the year to it or its members or depositors by a deposit insurance corporation. These paragraphs are amended to provide that such assistance is required to be included in computing the member institution's income for the year only to the extent that the institution has not repaid the assistance in the year.

Paragraph 137.1(10)(c) of the Act provides that where an obligation of a member institution to pay an amount to a deposit insurance corporation is settled or extinguished in a taxation year without full payment, the member institution is required to include the unpaid amount in computing its income for the year. Paragraph (c) is amended to provide that the unpaid amount is to be included in computing the member institution's income for the year to the extent that it is not otherwise required to be included in computing the member institution's income for the year or a preceding taxation year. Thus, where assistance provided by a deposit insurance corporation is included in a member institution's income under paragraph 137.1(10)(a) or (b), no portion of that amount will be included in the member's income again under paragraph 137.1(10)(c) if the member's obligation to repay the assistance to the deposit insurance corporation is settled or extinguished without full payment.

New subsection 137.1(10.1) of the Act provides that for the purposes of paragraph 137.1(10)(c), the principal amount of an amount payable by a member institution to a deposit insurance corporation will include the obligation to pay interest. This rule ensures that a member institution will have an income inclusion wherever its obligation to pay interest to a deposit insurance corporation is settled or extinguished without full payment.

New subsection 137.1(10.1) and the amendments to subsection 137.1(10) are applicable to the 1983 and subsequent taxation years.

Subclause 49(6)

ITA
137.1(12)

New subsection 137.1(12) of the Act allows a member institution, which in a year repays an amount of assistance received by it or its members or depositors from a deposit insurance corporation in a preceding year, to exclude the repayment from the amount of assistance originally included in computing the member institution's income for the preceding year. This exclusion is permitted only where the member institution has filed its tax return for the preceding year, and is obtained by filing an amended return for the preceding year on or before the tax return due date for the year in which the repayment is made. The amended return may also be filed within 90 days of Royal Assent to the implementing legislation. New subsection 137.1(12) is applicable to the 1983 and subsequent taxation years.

Exempt Persons

Clause 50

Section 149 of the Act exempts certain taxpayers from tax under Part I of the Act and provides special rules relating to such taxpayers.

Subclause 50(1)

ITA
149(1)(o.4)

Subsection 149(1) of the Act provides an exemption from Part I tax for the taxable income of certain trusts governed by registered pension funds or plans. New paragraph 149(1)(o.4) extends this exemption to those trusts (referred to as "master trusts") that hold investments exclusively for registered pension funds or plans and that elect to have the provisions of the paragraph apply. This exemption is intended to simplify the administration and ease the tax compliance of such trusts. In the absence of this provision, the trust income computed in accordance with Part I must actually be distributed each year to the beneficiaries to avoid having Part I tax payable by the trust even though all of the beneficiaries of the trust are exempt from tax under Part I. This change is applicable to the 1987 and subsequent taxation years.

Subclause 50(2)

ITA 149(1)(q.1)

New paragraph 149(1)(q.1) of the Act, applicable after October 8, 1986, is consequential on the introduction of the new rules relating to retirement compensation arrangements and adds an "RCA trust" to the list of persons exempt from tax under Part I of the Act. While an RCA trust is not subject to Part I tax, the custodian of an RCA trust is subject to a special refundable tax under new Part XI.3 of the Act as described in the commentary on new sections 207.5 to 207.7.

Subclause 50(3)

ITA 149(10)

Subsection 149(10) of the Act provides special rules where a corporation ceases to be exempt from tax under Part I of the Act, to ensure that any gain or loss subsequently realized by the corporation when it is taxable does not include any gain or loss that accrued when the corporation was tax-exempt. The opening words of subsection 149(10) are amended to make the subsection also apply where a corporation becomes exempt from tax under Part I of the Act after June 3, 1987. As a result, any gains or losses that accrued before the corporation becomes tax-exempt will be recognized before the corporation becomes tax-exempt.

ITA 149(10)(a)

Paragraph 149(10)(a) of the Act provides that the taxation year of a corporation that would otherwise have included the time of the change in its tax status is treated as having ended at that time and a new taxation year is considered to have commenced immediately thereafter. The amendment to this paragraph treats the taxation year that would otherwise have included that time as having ended immediately before that time and the new taxation year is considered to start at that time. This amendment is applicable where, after January 15, 1987, a corporation becomes or ceases to be exempt from tax under Part I of the Act.

ITA 149(10)(b)

Paragraph 149(10)(b) of the Act treats a corporation as having disposed, immediately before the time of the change in its tax status, of all of its property (other than a Canadian or foreign resource property) for fair market value and to have reacquired the property immediately after that time at that value. There are three amendments to this paragraph. One changes the time of the disposition of the property to immediately before the time at which the taxation year of the corporation is treated by paragraph (a) as having ended (which time is immediately before the change in tax status). A second amendment changes the time of the reacquisition of the property to the time of the change of tax status. The third amendment makes the paragraph's disposition and reacquisition rules apply to a corporation's Canadian and foreign resource properties where a corporation becomes exempt from tax. As a result, any accrued gains or recaptured deductions with respect to such resource properties are recognized before the corporation becomes tax-exempt. Where a corporation ceases to be exempt from tax, paragraph 149(10)(b) will continue not to apply because in that circumstance the successor rules for resource expenses apply. The amendments to paragraph 149(10)(b) of the Act are applicable where a corporation becomes, or ceases to be, exempt from tax under Part I of the Act after June 3, 1987.

ITA
149(10)(c)

Paragraph 149(10)(c) of the Act provides that where depreciable property having a fair market value less than its capital cost is treated by paragraph (b) as having been disposed of and reacquired, the original capital cost is maintained and the difference between the fair market value and the capital cost is treated as having been allowed as capital cost allowance. As a consequence of the changes in paragraph (b) to the times at which the property is considered to have been disposed of and reacquired, paragraph (c) is amended to provide that it is the capital cost immediately before the disposition that continues to be the corporation's capital cost as of the time of the change in tax status of the corporation. This amendment is applicable where a corporation becomes, or ceases to be, exempt from tax under Part I of the Act after June 3, 1987.

Subclause 50(4)

ITA
149(10)(d)

New paragraph 149(10)(d) of the Act imposes a restriction on the extent to which a corporation may carry forward losses incurred before a change in its tax status for deduction after the change. Normally, paragraph 111(3)(a) provides that a deduction in a taxation year in respect of a loss carryover may be claimed only to the extent that the carryover exceeds the amount thereof that was deducted in preceding taxation years. New paragraph 149(10)(d) amends this requirement in paragraph 111(3)(a) so that losses incurred before a change in tax status of a corporation may not be deducted in computing the taxable income of the corporation for a taxation year ending after the change in tax status if they could have been applied to reduce the corporation's taxable income for taxation years ending before the change in tax status. New paragraph 149(10)(d) is applicable where a corporation becomes, or ceases to be, exempt from tax under Part I of the Act after June 3, 1987.

Deductions at Source

Clause 51

Section 153 of the Act authorizes the withholding of tax from any of the payments described in paragraphs 153(1)(a) to (o). The person making the payment is required to remit any tax so withheld to the Receiver General on behalf of the payee. The amount of tax to be deducted or withheld is determined in Part I of the *Income Tax Regulations*.

Subclause 51(1)

ITA
153(1)(p), (q) and (r)

New paragraphs 153(1)(p), (q) and (r) of the Act authorize tax to be deducted at source from certain payments relating to retirement compensation arrangements. The affected payments include

- contributions by an employer to a custodian of the arrangement,
- benefits under the arrangement paid by a custodian, and
- a payment on account of the purchase price of an interest in the arrangement.

These new paragraphs are added to section 153 and are applicable with respect to any such payments made after March 27, 1987 – the date on which the rules relating to such arrangements were made public. The *Income Tax Regulations* will be amended effective as of the same date to require the withholding of 50 per cent from contributions to an RCA and payments on account of the purchase price of an RCA and to require deduction at source from benefits paid out of an RCA at the rates appropriate for remuneration paid to an employee.

Subclause 51(2)

ITA
153(4) and (5)

Where a broker or dealer in securities has, within the 12-month period immediately preceding a particular taxation year, received dividends on shares of which the beneficial owner is unknown to him at the end of the year, existing subsection 153(4) of the Act requires the broker or dealer to remit on account of the beneficial owner's tax an amount equal to 25 per cent of the amount of such dividends.

This amendment to subsection 153(4) extends this withholding tax obligation to all taxpayers who, after 1984 and before a particular taxation year, have received dividends, interest or proceeds of disposition of property in respect of which the person beneficially entitled thereto is unknown to the taxpayer at the end of that year. In the case of dividends, the rate of withholding tax established by this amendment is 33 1/3 per cent, reflecting the approximate rate of tax payable on dividend income by individuals who are subject to tax at the highest marginal rate. In the case of interest and proceeds of disposition, the withholding tax rate is 50 per cent, reflecting the approximate rate of tax payable when such amounts constitute income of high-rate taxpayers. In all cases, this remittance is to be made within 60 days following the end of the taxation year of the taxpayer.

No remittance is required in respect of an amount on which tax under subsection 153(4) was paid in a preceding taxation year or that was included in computing the taxpayer's income for the current year or an earlier year. Also, in the case of proceeds of disposition of property, the remittance required under this subsection is limited to the amount by which such proceeds exceed any outlays or expenses incurred by the taxpayer in order to dispose of the property.

Subsection 153(5) of the Act provides that an amount remitted by a broker or dealer in securities to the Receiver General on account of the tax payable in respect of dividends on shares of which the beneficial owner is unknown is considered to have been received by the beneficial owner and to have been deducted or withheld from the amount otherwise payable to him. The amendment to this subsection considers the same events to have occurred where a taxpayer has, pursuant to amended subsection 153(4), remitted an amount to the Receiver General in respect of dividends, interest or proceeds of disposition of property where the person beneficially entitled thereto is unknown.

These amendments are applicable for taxation years commencing after 1986.

Joint and Several Liability – Non-Arm's Length Transfers

ITA
160(1)

Clause 52

Subsection 160(1) of the Act provides that the non-arm's length transferee of property is jointly and severally liable to pay the taxes of the transferor in respect of the taxation year in which the property is transferred or any preceding year up to the excess of the fair market value of the property over the consideration given for the property. Paragraph 160(1)(e)(ii) is amended to clarify that the joint liability applies not only to taxes payable on the income of the transferor but also to any liability for source deductions which the transferor is liable to remit in that or a preceding year.

Joint and Several Liability – RCA Benefits

ITA
160.3

Clause 53

New paragraph 56(1)(x) of the Act provides that benefits received by a person out of a retirement compensation arrangement that relate to another taxpayer's employment must be included in computing that other taxpayer's income. New section 160.3 provides that where the person receiving the benefit is not at arm's length with the other taxpayer, they will be jointly and severally liable for the portion of that other taxpayer's tax that is attributable to such benefits. Subsection 160.3(1) establishes the amount of the joint and several liability. Subsection (2) authorizes the Minister of National Revenue to issue the appropriate assessments and subsection (3) provides for the satisfaction of the joint and several liability on payments by either party. These provisions parallel the existing provisions relating to joint and several liability for payments out of an RRSP after the death of the annuitant (section 160.2) and for property transferred between spouses (section 160).

This new subsection is applicable after October 8, 1986.

Offset Interest

ITA
161(2.2)

Clause 54

New subsection 161(2.2) of the Act will permit the use of an interest offset method in the calculation of interest chargeable on late or deficient tax instalment payments under subsection 161(2) of the Act. Under this offset method, a taxpayer can reduce or eliminate interest charged on a deficient tax instalment by overpaying other instalments or paying other instalments before their due date. Instalment interest is calculated by first computing a debit interest charge from the due date of each instalment to the date the final instalment is due (balance due date). A credit offset (offset interest) is allowed on each instalment payment at the instalment interest rate from the payment date to the balance due date. Interest will be chargeable only to the extent that the debit instalment interest charge exceeds the offset interest.

This new subsection is applicable for taxation years commencing after 1986.

Garnishment of Tax Refunds

Clause 55

ITA
164(1.4)

New subsection 164(1.4) of the Act provides authority for the garnishment, for the purposes of the Family Orders and Agreements Enforcement Assistance Act, of the provincial portion of income tax refunds payable by the Minister of National Revenue after Royal Assent to the enabling legislation. The Family Orders and Agreements Enforcement Assistance Act allows a creditor-spouse to garnishee tax refunds of a debtor-spouse whose support obligations are in arrears. Tax refunds are made up of overpayments on account of federal and provincial tax and federal and provincial tax credits. The federal government has entered into tax collection agreements with nine provinces and the territories to act as their agent for the collection of personal income tax. The federal Crown, as agent, has agreed to refund to taxpayers on behalf of the provinces, the overpayments on account of provincial tax as well as certain provincial tax credits. To permit garnishment of provincial refunds, new subsection 164(1.4) establishes a debtor-creditor relationship between the federal Crown and the debtor-spouse.

3-Per-Cent Individual Surtax

Clause 56

ITA
180.1(4)

Section 180.1 of the Act imposes a surtax calculated by reference to the tax payable under Part I. Subsection 180.1(4) provides for the application, for the purposes of this surtax, of certain provisions of Part I relating to payments, assessments, appeals and other administrative matters. The amendment to this section extends the application of subsection 180.1(4) to the 1987 and subsequent taxation years.

Tax on Corporate Distributions

Clause 57

Part II.1
ITA
183.1 and 183.2

New Part II.1 of the Act introduces an anti-avoidance provision that is intended to prevent tax avoidance on corporate distributions that might otherwise be achieved where a corporation effects a distribution of corporate surplus, directly or indirectly, to its shareholders who are individuals as proceeds of disposition of a share. The measure will take the form of a special tax to be paid by the corporation that effects the distribution.

New section 183.1 of the Act sets out the main rules. The section applies only where all of the following conditions set out in new subsection 183.1(1) are present:

(a) a corporation resident in Canada (other than a mutual fund corporation as defined in subsection 131(8)), referred to as the "acquiring corporation", or any other person or partnership must have acquired shares of the capital stock of the acquiring corporation as part of a transaction or series of transactions or events;

(b) subsection 84(2) or (3) must not have applied to treat the acquiring corporation as having paid a dividend on the acquisition of the shares;

(c) the consideration for the acquisition of the shares must have exceeded their paid-up capital immediately before the acquisition; and

(d) it must be reasonable to consider that a purpose of the acquisition was to enable shareholders who are individuals to realize, directly or indirectly, a distribution of corporate surplus by the acquiring corporation as proceeds of disposition of a share.

Where these conditions are present, the acquiring corporation must pay a tax on the excess of the consideration paid or payable for the acquisition of the shares over their paid-up capital. For shares acquired after November 27, 1986 and before 1987, the tax will be 33 1/3 per cent of the excess. This rate equates with the 25 per cent rate of tax payable on dividend income by individual shareholders in the upper-income ranges. The rate of the special tax on the excess consideration paid or payable will increase to 50 per cent for share acquisitions after 1986 as a consequence of the changes to the dividend tax credit effective January 1, 1987.

An example of the series of transactions or events to which subsection 183.1(1) may apply involves the payment of a stock dividend by a corporation to shareholders where the stock dividend shares received have a low paid-up capital and a high fair market value followed by a repurchase of those shares by the corporation. In the case of a stock dividend paid by a public corporation, the re-acquisition of the stock dividend shares or other shares of the same class in the open market by the corporation represents a surplus distribution that would be treated by shareholders as proceeds of disposition rather than dividends. In the case of a stock dividend paid by either a private or a public corporation, tax on the corporate distribution could be avoided through a subsequent acquisition of the stock dividend share by a corporation related to the issuing corporation or a third party broker or dealer where the purchase price of the share is funded by the acquiring corporation.

Another type of transaction to which the new provision may apply is an acquisition of shares for an amount that reflects a future dividend payment. For example, a share may be issued for $90 and be redeemable for $100. Just before the redemption date, the share could be purchased for the $100 amount in the open market by the issuing corporation or a non-arm's length person so that the shareholder realizes a capital gain rather than a deemed dividend.

A third type of transaction that could be subject to the new provision is one that is designed to allow employees to receive a bonus, salary or portion of his employer's profit as a capital gain. For example, an employee of a private corporation could subscribe for preferred shares of his employer on which the employer will pay preferred share stock dividends with a redemption price based on profit performance. Prior to redemption, the stock dividend shares might be purchased by a sister company, thereby allowing the employee to receive a distribution of his employer's surplus as a capital gain.

The purpose test in new paragraph 183.1(1)(c) is intended to exclude bona fide commercial transactions from the application of the new provision where surplus stripping is not a significant consideration. For example, not every purchase by a public corporation of its shares in the open market is intended to be subject to new subsection 183.1(1). Where this purchase is motivated by commercial reasons and not for the purpose of allowing shareholders of the corporation who are individuals to realize surplus of the corporation as capital gains, new subsection 183.1(1) does not apply. Similarly, corporate reorganizations and other types of transactions that are not designed to strip surplus from a corporation are also intended to be excluded.

New subsection 183.1(2) contains rules designed to ensure the effective application of the provisions of new subsection 183.1(1). New paragraph 183.1(2)(a) is intended to ensure that the rules in new subsection 183.1(1) cannot be avoided by substituting certain types of property for the shares of the acquiring corporation. This new paragraph applies, for example, where the acquiring corporation effects a corporate distribution as proceeds of disposition of a property by acquiring a property that is a share of another corporation or an interest in a partnership or trust that was substituted for a share of the acquiring corporation. For example, a taxpayer could transfer his share of the acquiring corporation to a holding company and take back shares in the holding company. The acquiring corporation could purchase the shares of the holding company, giving the shareholder a capital gain, and then wind up the holding company. The effect of this rule is to treat the person or partnership that acquired the property as having acquired the share of the acquiring corporation and not the substituted property for the amount of consideration paid or payable by it for the substituted property. Therefore, new subsection 183.1(1) will apply to the transaction. New paragraph 183.1(2)(b) provides that, for the purposes of new subsection 183.1(1), a distribution of corporate surplus will be treated as having taken place where the consideration for the acquisition of a share exceeds its paid-up capital.

New subsection 183.1(3) is a relieving provision that provides that where the same share of an acquiring corporation is acquired more than once in the same series of transactions or events, new subsection 183.1(1) can be applied only in respect of one of those acquisitions. For example, an acquiring corporation could arrange to have a third party purchase shares of the acquiring corporation from the acquiring corporation's shareholders in order to effect a corporate distribution to them as a capital gain and fund the purchase price paid by the third party by a further acquisition by it of those shares for cancellation. Where subsection 183.1(1) has been applied in respect of the first acquisition by the third party, it cannot be applied in respect of the second acquisition by the acquiring corporation.

New subsection 183.1(4) provides that the new tax will not apply where the acquisition of the share of an acquiring corporation was part of a bona fide arm's length takeover, the buy-out of an arm's length minority shareholder or a qualifying purchase of prescribed shares of employees of the corporation or a non-arm's length corporation.

New paragraph 183.1(4)(a) will exclude an acquisition of the shares of an acquiring corporation where the acquisition was part of a series of transactions or events the principal purpose of which was to effect an acquisition of control of that acquiring corporation or a predecessor corporation of that acquiring corporation by one or more persons or partnerships who were dealing at arm's length with one or more persons or partnerships who controlled or were part of a group that controlled that acquiring corporation or predecessor corporation, as the case may be, immediately before the commencement of the series. An example might be a transaction involving an amalgamation or merger of two arm's length corporations as part of a takeover transaction. On the amalgamation, the shareholders of the target predecessor corporation exchange their shares for shares of the amalgamated corporation and these shares are subsequently purchased by the amalgamated corporation or a person or a partnership that does not deal at arm's length with the amalgamated corporation. If the acquisition of those shares was part of a series of transactions or events the principal purpose of which was to effect an acquisition of control of a corporation by a person or persons that dealt at arm's length with the person or persons that previously controlled the corporation, new subsection 183.1(1) will not apply.

New paragraph 183.1(4)(b) excludes an acquisition of a share from the application of subsection 183.1(1) where the share was acquired as part of a series of transactions or events the principal purpose of which was to acquire all of the shares of the acquiring corporation or a predecessor corporation of the acquiring corporation, as the case may be, owned by a person or partnership who was dealing at arm's length with the acquiring corporation in order to increase the controlling interest of one or more shareholders that controlled the acquiring corporation or the predecessor corporation, as the case may be.

New paragraph 183.1(4)(c) excludes, from the application of subsection 183.1(1), an acquisition of a share of the capital stock by an acquiring corporation where that share was acquired as part of a series of transactions or events the principal purpose of which was to effect an acquisition of a prescribed share of the acquiring corporation owned by an employee of the acquiring corporation or a corporation with which it did not deal at arm's length where certain conditions have been met. The employee must deal at arm's length with the acquiring corporation and the corporation of which he is an employee and the acquisition of the share must have been pursuant to an employee share purchase agreement in order to protect the employee against any loss in respect of the share or provide a market for the share. Where the share was purchased to protect the employee against any loss, the consideration for the acquisition of the share cannot exceed the lesser of the cost or the adjusted cost base of the share to the employee immediately before it was acquired. Where the share was purchased to provide a market for the share, the consideration for the acquisition of the share cannot exceed the share's fair market value immediately before it was acquired. A prescribed share is intended to be a common share of the acquiring corporation and to exclude preferred shares. The proposed definition of "prescribed share" is set out in draft section 6207 of the *Income Tax Regulations.*

New subsection 183.1(5) provides rules for the purposes of new paragraphs 183.1(4)(a) and (b) of the Act where the acquiring corporation has been formed as a result of an amalgamation. For the purposes of paragraph 183.1(4)(a), control of a predecessor of the acquiring corporation will be considered to have been acquired if, immediately after the amalgamation, the shareholders that controlled the acquiring corporation are not the shareholders that controlled that predecessor corporation immediately before the amalgamation. For the purposes of paragraph 183.1(4)(b), the shareholders that controlled a predecessor corporation of the acquiring corporation will be considered to have increased their degree of control of that predecessor if, immediately after the amalgamation, their degree of control of the acquiring corporation exceeded their degree of control of the predecessor immediately before the amalgamation.

New subsection 183.1(6) of the Act ensures that the acquiring corporation will not be taxed on an acquisition of a share of the capital stock of the acquiring corporation where section 84.1 or 212.1 or subsection 84(8) applied or subsection 110.6(8), 245(1.1) or 247(1) has been applied in respect of the acquisition or the series of transactions or events of which the acquisition was part.

New section 183.2 of the Act sets out the administrative provisions for the Part II.1 tax. New subsection 183.2(1) requires a corporation liable to pay tax under Part II.1 for a taxation year to file its return of income under that Part in prescribed form by the date on which its regular tax return for the year is required to be filed.

New subsection 183.2(2) of the Act sets out the rules relating to interest on late or deficient payments, appeals and various other procedural and administrative matters with respect to the Part II.1 tax.

New Part II.1 is applicable with respect to acquisitions of shares after November 27, 1986 other than shares acquired before 1987 pursuant to a written commitment made before November 28, 1986.

Exemption from Part IV Tax

Clause 58

ITA
186.1(b)

Section 186.1 of the Act lists those corporations which are exempt from paying the special refundable Part IV tax on dividend income. The existing reference to prescribed venture capital corporations is designed to exempt dividends received by such corporations on investments qualifying under the provincial venture capital programs rather than to exempt all dividends received by such corporations. Consistent with this intention, new subsection 186.2 provides a limited exemption for such corporations, as described in the commentary on that subsection. Consequently, paragraph 186.1(b) is amended, effective for taxation years ending after February 18, 1987, to delete the reference therein to prescribed venture capital corporations.

Part IV Tax – Prescribed Venture Capital Corporations

Clause 59

ITA
186.2

New section 186.2 provides that certain dividends received in a year by a corporation that was, throughout the year, a prescribed venture capital corporation are not considered to be taxable dividends. As a consequence, such dividends do not give rise to Part IV tax. For dividends received after February 17, 1987, this provision is applicable only to dividends received from corporations that are prescribed qualifying corporations with respect to the dividends. A prescribed qualifying corporation will be defined in the *Income Tax Regulations* by reference to the status of the shares of the corporation at the time of their acquisition by the prescribed venture capital corporation. If the shares qualify as eligible investments under the applicable provincial venture capital program at such time, the issuer of the share will constitute a prescribed qualifying corporation. The amendment is applicable to dividends received in taxation years ending after February 17, 1987 and a special transitional rule ensures that all dividends received in that taxation year and before February 18, 1987 are exempt from Part IV tax for prescribed venture capital corporations.

Part XI – Persons Subject to Tax on Foreign Property

Clause 60

ITA
205(a)

Section 205 of the Act lists those taxpayers subject to the provisions of Part XI which levy a penalty tax in respect of excess foreign property holdings of registered pension funds or plans and other exempt deferred income plans or funds. The amendment to this section relates to certain trusts that are referred to in the Act as "master trusts" which are described in the commentary on paragraph 149(1)(o.4). A master trust that elects under new paragraph 149(1)(o.4) is exempt from tax under Part I. However, it is appropriate that such trusts be subject to the foreign property provisions of Part XI. Accordingly, paragraph 205(a) is amended for months ending after 1986 to include a reference to master trusts that elect under new paragraph 149(1)(o.4). This change also permits such a trust to hold the additional "3 for 1" foreign property pursuant to paragraph 206(2)(c) where it invests in small business properties.

Part XI – Tax on Foreign Property

Clause 61

Part XI of the Act sets out the rules for the 1 per cent per month penalty tax on deferred income plans or funds, master trusts and registered investments listed in section 205 in respect of their excess foreign property holdings.

Subclause 61(1)

ITA
206(1)

Subsection 206(1) of the Act contains the definitions of certain terms for the purposes of Part XI. The amendment to the definition of "small business investment amount" substitutes the words "cost amounts" for "fair market values, at the time of acquisition". This change ensures that tax cost rather than the fair market value basis of measurement applies to property that is acquired on certain reorganizations, the exercise of stock rights or warrants, the conversion of securities or the payment of stock dividends.

This amendment to subsection 206(1) is applicable for months ending after January 1, 1988, or such earlier months that end after 1984 as a taxpayer elects in his Part XI return for 1987.

Subclause 61(2)

ITA
206(2)

The tax payable under Part XI is determined under subsection 206(2) of the Act. The amendments to this subsection substitute the words "cost amount" for the words "fair market value, at the time of acquisition". These changes ensure that tax cost rather than the fair market value basis of measurement applies to property that is acquired on certain reorganizations, the exercise of stock rights or warrants, the conversion of securities or the payment of stock dividends.

These amendments are applicable for months ending after January 1, 1988, or such earlier months that end after 1984 as a taxpayer elects in his Part XI return for 1987.

Subclause 61(3)

ITA
206(2.1)

New subsection 206(2.1) of the Act is consequential upon the introduction of new paragraph 149(1)(o.4), and the related amendment to paragraph 205(a), both of which relate to master trusts. This provision enables a master trust subject to the foreign property rules to benefit from the special elective provisions contained in section 259 of the Act – for example, where the foreign property holdings of the trust exceed the limits provided in Part XI. The beneficiaries of a trust that has elected under subsection 259(2) are treated for various purposes, including the foreign property rules, as owning their proportionate share of the properties of the trust rather than an interest in the trust. New subsection 206(2.1) exempts a master trust from the foreign property provisions for any month that is covered by an election under subsection 259(2). In this case, the foreign property rules will apply to the pension plan beneficiaries of the trust with respect to any foreign investments held by the trust. New subsection 206(2.1) is applicable to months ending after 1986.

Subclause 61(4)

ITA
206(4)

Subsection 206(4) of the Act is amended as a consequence of the changes to subsections 206(1) and (2) described in the commentary on those subsections. New subsection 206(4) provides, for the purposes of Part XI, that property acquired from persons with whom the purchaser does not deal at arm's length for less than fair market value consideration is treated as having been acquired at its fair market value at the time of its acquisition. For this purpose, trusts that have the same beneficiary are considered not to deal with each other at arm's length.

This new subsection is applicable for months ending after January 1, 1988, or such earlier months that end after 1984 as a taxpayer elects in his tax return for 1987 to have the amendments to Part XI apply.

RCA Refundable Tax

Clause 62

ITA
Part XI.3

New Part XI.3 of the Act provides for a special 50 per cent refundable tax that applies to custodians of retirement compensation arrangements (RCAs). Under this new Part, which is generally applicable after October 8, 1986, any such arrangement is required to maintain a refundable account and, on filing its special tax return for a year, the custodian is required to ensure that the full balance of the account has been paid to the Receiver General. Thus, the custodian must then pay the amount of any shortfall on this account and is entitled to a refund to the extent of any overpayments.

ITA
207.5(1)

New subsection 207.5(1) of the Act sets out the main definitions required for the purposes of the new Part XI.3 tax.

"refundable tax"

The refundable tax of an RCA at the end of a taxation year is defined as the aggregate of

- 50 per cent of all contributions made under the arrangement before that time, and
- 50 per cent of the amount, if any, by which the income (determined without any dividend gross-up under paragraph 82(1)(b) of the Act) or capital gains of the arrangement exceed its losses or capital losses for the year or any preceding taxation year

less 50 per cent of all benefits paid under the arrangement other than those benefits paid as part of a series of contributions and refunds.

The following example illustrates this refundable tax mechanism.

> Assume that an RCA trust is established in 1987 with a $10,000 contribution and earns interest in that year of $500. Its refundable tax at the end of 1987 would be $5,250 (50 per cent of $10,500). $5,000 of this tax would have been satisfied by deduction at source from the contribution and the remaining $250 would have to be paid by the custodian on filing his 1987 return. Further, if the trust earned $500 of interest in 1988 and paid benefits to an employee in that year of $3,000, its refundable tax at the end of 1988 would be $4,000 – that is, 50 per cent of $8,000 ($10,000 in contributions plus $1,000 in interest minus $3,000 of benefits paid). In this case, the custodian of the trust on filing its tax return for 1988 would be entitled under subsection 207.7(2) to a refund of $1,250 – that is, the excess of its refundable tax at the end of 1987 ($5,250) over its refundable tax at the end of 1988 ($4,000).

It is also possible for a refund to arise where the amount of tax withheld from contributions to a custodian in a year exceeds the refundable tax payable by him for the year.

"RCA trust"

An RCA trust is a trust governed by a retirement compensation arrangement and, in the case of a non-trusteed arrangement, the trust that by virtue of new subsection 207.6(1) of the Act is considered to be created in respect of the subject property of the RCA.

"subject property"

Subject property of an RCA is the property held in connection with the arrangement.

ITA
207.5(2)

New subsection 207.5(2) of the Act provides a special rule that permits a custodian to recover refundable tax where an RCA suffers losses on its investments or is terminated. Under this provision, if the property of the arrangement at the end of a year, other than its right to claim a refund of refundable Part XI.3 tax, consists solely of cash, debt obligations and shares listed on a prescribed stock exchange, the custodian may elect to use a special method to determine its refundable tax at the end of that year. Under this method the refundable tax at the end of a year is equal to the total at the end of the year of its cash, the greater of the principal amount or the fair market value of its investments that are debt obligations, and the fair market value of its investments in shares. The special election must be made annually. If it is not made for a year, refundable tax is determined at the end of that year in the manner set out in new subsection 207.5(1).

ITA 207.6(1)

New section 207.6 of the Act provides a number of special rules for the purposes of the provisions of the Act relating to retirement compensation arrangements. New subsection 207.6(1) provides special rules that apply where an RCA is established without the creation of a trust. In this case, an *inter-vivos* trust is considered to have been created, the "subject property" of the arrangement is treated as the property of this trust and the custodian is deemed to be the trustee of the trust. The *inter-vivos* trust will therefore constitute an "RCA trust" as defined in new section 207.5.

ITA 207.6(2)

New subsection 207.6(2) of the Act provides special rules where a life insurance policy, including an annuity, is acquired in connection with a retirement compensation arrangement. In the absence of these special rules, the life insurance company as issuer of the policy would be the custodian since the company is the person to whom the contribution – that is, the premium for the policy – is paid. However, under this subsection, the person who acquires the policy is considered to be the custodian of the arrangement, the life insurance policy is considered to be the "subject property" of the arrangement, the premiums paid under the policy are treated as contributions to the arrangement, and payments under the policy and refunds of refundable tax are treated as distributions by the arrangement. Thus, the employer will be required to withhold tax from any payment towards the policy and to file the returns and pay the special 50 per cent refundable tax required under section 207.7.

ITA 207.6(3)

New subsection 207.6(3) of the Act is designed to preclude the use of personal service corporations to circumvent the new rules relating to retirement compensation arrangements. Thus, where a personal service corporation or its employee enters into an arrangement with a person to whom the corporation is providing services (the "employer") and benefits are provided under the arrangement on, after or in contemplation of a substantial change in the services provided to the employer by the corporation, or by the employee on the corporation's behalf, the following rules apply:

- an employer-employee relationship is considered to exist between the employer and the personal service corporation, and
- the benefits under the arrangement are considered to be benefits received or enjoyed on, after or in contemplation of a substantial change in the services rendered by the corporation.

The result is that the plan or arrangement, depending on its terms, may constitute a retirement compensation arrangement as defined in section 248.

ITA
207.6(4)

New subsection 207.6(4) of the Act provides a special rule where an employee benefit plan becomes a retirement compensation arrangement by virtue of the custodian changing his residence or ceasing to carry on business through a fixed place in Canada or to be licensed in Canada to offer its services to the public as a trustee. These special rules may apply where an employee benefit plan of a professional athlete becomes a retirement compensation arrangement because the custodian no longer satisfies the necessary conditions set out in paragraph (j) of the definition of an RCA in section 248. In this circumstance, the custodian of the plan is treated as having made a contribution to an RCA equal to the fair market value of the properties of the plan. As a result, the custodian will be required under section 153 of the Act to withhold the 50 per cent tax from the amount that is treated as a contribution. The purpose of new paragraph 207.6(4)(b) is to ensure that the employer who had made non-deductible contributions to the plan while it was an employee benefit plan may obtain a deduction in computing his income at such time as the plan becomes a retirement compensation arrangement. The rules in section 32.1 of the Act relating to employee benefit plans allow a deduction to an employer only at such time as the benefits are received by, and included in the income of, the employee.

ITA
207.6(5)

Paragraph (l) of the definition "retirement compensation arrangement" excludes most foreign pension or retirement benefit plans maintained primarily for the benefit of non-residents in respect of services rendered outside Canada. The purpose of the special rule in new subsection 207.6(5) is to ensure that such foreign plans cannot be used to provide retirement benefits for Canadian resident employees in a way that circumvents the rules relating to retirement compensation arrangements. The rule applies where contributions are made to the foreign plan in respect of services rendered by an employee resident in Canada unless the employee was a member of the plan before he became a Canadian resident and the contributions were made in respect of services rendered during the first 36 months of his becoming a resident. This latter exception from the rules is intended to accommodate those non-residents who move to Canada at a time when they are members of a foreign pension plan. Contributions to the foreign plan for a period of three years following the establishment of Canadian residence by the employees will be considered not to have been made to an RCA. This 36-month rule is patterned on the existing rule in subsection 18(10) relating to contributions to employee benefit plans established outside Canada.

Except where excluded under the circumstances described above, to the extent that contributions are made to a foreign pension or retirement benefit plan in respect of services rendered by an employee resident in Canada, that foreign plan will be considered to be a retirement compensation arrangement in respect of that employee.

ITA
207.7

New subsection 207.7 of the Act deals with the filing of Part XI.3 returns and the payment and refund of the special refundable tax.

New subsection 207.7(1) requires a custodian of a retirement compensation arrangement to pay to the Receiver General for a taxation year the amount, if any, by which his refundable tax at the end of the year exceeds his refundable tax at the end of the preceding year.

Under new subsection 207.7(2) the Minister of National Revenue is required to refund to the custodian the amount, if any, by which the custodian's refundable tax at the end of the preceding year exceeds his refundable tax at the end of the year.

New subsection 207.7(3) requires the custodian to file a tax return for the arrangement for a taxation year and pay any refundable tax owing within 90 days of the end of the year.

Certain administrative, collection, and appeal provisions that apply for the purposes of Part XI.3 are set out under new subsection 207.7(4).

New Part XI.3 is applicable after October 8, 1986 except that no returns need to be filed nor tax paid until 90 days after Royal Assent to the implementing legislation.

Non-Resident Withholding Tax

Clause 63

Section 212 is the principal provision of the Act dealing with the 25 per cent withholding tax imposed on payments to non-residents.

Subclause 63(1)

ITA 212(1)(b)(xi)

New subparagraph 212(1)(b)(xi) of the Act provides that interest payable by a prescribed financial institution on an eligible deposit is exempt from non-resident withholding tax under section 212 of the Act. "Eligible deposit" has the meaning assigned under new section 33.1 of the Act which provides special rules relating to the tax treatment of international banking centre businesses. It is proposed that institutions prescribed for the purpose of clause 212(1)(b)(iii)(D) of the Act be prescribed for the purpose of this subparagraph. This new subparagraph applies with respect to interest payable for taxation years commencing after the enabling legislation receives Royal Assent.

Subclause 63(2)

ITA 212(1)(j)

Paragraph 212(1)(j) is amended so that the 25 per cent non-resident withholding tax applies to benefits paid or credited by a custodian of a retirement compensation arrangement to a non-resident. The withholding tax will also apply to payments to a non-resident on account of the purchase price of an interest in an RCA. This amendment is applicable to amounts paid or credited after March 27, 1987 – the date on which the new rules relating to such arrangements were made public.

Subclause 63(3)

ITA
212(13)(c)

The amendment to paragraph 212(13)(c) of the Act ensures that the 25 per cent non-resident withholding tax applies to benefits under a retirement compensation arrangement paid to a non-resident even where the custodian under the arrangement is a non-resident. This is achieved by treating the custodian as resident in Canada for the purpose of the rules in section 212. This amendment is applicable to amounts paid or credited after March 27, 1987.

Rule Relating to Non-Resident Withholding Tax

Clause 64

ITA
214(3)

Subsection 214(3) of the Act is amended as a consequence of the amendment to paragraph 212(1)(j). New paragraph 214(3)(b.1) provides that an amount that has become receivable in respect of the disposition by a non-resident of an interest in a retirement compensation arrangement is considered, for the purposes of the 25 per cent non-resident withholding tax, to have been paid to the non-resident. As a result, the tax under paragraph 212(1)(j) will be required to be withheld by the purchaser. This amendment is applicable to amounts paid or credited after March 27, 1987 – the date on which the rules relating to such arrangements were made public.

Security

Clause 65

ITA
220(4.3) and (4.4)

New subsection 220(4.3) of the Act allows a member institution of a deposit insurance corporation to post security with Revenue Canada, Taxation after February 17, 1987 in respect of the tax and interest thereon resulting from the inclusion in its income of assistance received from a deposit insurance corporation. This will allow the member institution to postpone payment of that tax and interest until the earlier of 10 years after the end of the taxation year in which the assistance was received or the day on which the member institution's obligation to repay the assistance is settled or extinguished.

New subsection 220(4.4), also applicable after February 17, 1987, allows Revenue Canada, Taxation to determine the adequacy of the security furnished and to require further security if it determines that the security furnished is no longer adequate.

Garnishment

Clause 66

Subclause 66(1)

ITA
224(1.2)
and (1.3)

Subsection 224(1) provides for garnishment action where a person is liable to make a payment to a tax debtor. The amendment ensures that garnishment action can be taken where, as a result of an assignment of property or other security interest, payments are redirected to a secured creditor of the tax debtor. Subsections 224(1.2) and (1.3) provide that where a payment is redirected to a secured creditor of the tax debtor, the Minister of National Revenue may, notwithstanding the claim or security interest of the secured creditor, intercept the payment and apply it to the tax debtor's liability for any source deductions – such as tax withheld from remuneration paid to employees and the non-resident withholding tax – he has failed to remit as required under the Act. These subsections effectively confer a priority on the Crown over the rights of certain secured creditors that benefit from an assignment of the property of the tax debtor in respect of payments to be made after notification to the person liable to make the payments. The definition of "secured creditor", "security interest" and "provisions similar" to subsection 227(10.1) are set out in subsection 224(1.3). This change is applicable to assessments in respect of amounts deducted or withheld after Royal Assent to the implementing legislation.

Subclauses 66(2) and (3)

ITA
224(4), (5) and (6)

Subsections 224(4), (5) and (6) relate to the failure to comply with a requirement to pay and the manner in which garnishees are to be served. These subsections are amended to refer to new subsection 224(1.2).

Withholding Taxes

Clause 67

Section 227 of the Act provides special rules relating to withholding taxes under the Act.

Subclause 67(1)

ITA
227(8)

Subsection 227(8) of the Act provides a penalty for failure to deduct or withhold amounts as required under the Act. This amendment is consequential on the acceleration of remittance of source deductions and ensures that interest on the amount that should have been deducted or withheld shall be calculated from the 15th day of the month following the month in which such amounts should have been deducted or withheld, or such earlier date as may be prescribed for the purposes of subsection 153(1) of the Act. Section 108 of the *Income Tax Regulations* will be amended to prescribe particular dates for employers required to remit source deductions twice monthly.

This amendment applies with respect to amounts required to be deducted or withheld after 1987.

Subclause 67(2)

ITA 227(8.2)

New subsection 227(8.2), applicable after March 27, 1987, provides that an employer who fails to withhold tax from a contribution to a retirement compensation arrangement is liable to pay an amount to Her Majesty equal to the contribution. The amount so paid is treated as a contribution to the arrangement and as such will be deductible by the employer in computing his income. In addition, the amount paid to Her Majesty will be treated as a payment of refundable tax under section 207.7 and as such may be recovered by the custodian on any subsequent distribution of benefits under the arrangement.

Subclause 67(3)

ITA 227(9)

Subsection 227(9) of the Act provides for a penalty and the payment of interest on late or deficient remittances of amounts required to be deducted or withheld as required under the Act or a regulation or in respect of the required tax with respect to amounts payable to non-residents under section 116 or a regulation made under subsection 215(4) of the Act. Interest on the late or deficient amount is calculated from the 15th day of the month following the month in which such amount was required to be deducted or withheld. This subsection is amended to provide that interest shall be calculated from the 15th day of the month following the month in which such amount was required to be deducted or withheld or from such earlier date as may be prescribed for the purposes of subsection 153(1) of the Act, in the case of amounts required to be deducted or withheld under the Act. In any other case, interest will be computed from the date the tax was required to be paid. Subsection 227(9) is also amended to clarify the dates on which a penalty may be imposed for failure to remit or pay an amount.

This amendment applies with respect to amounts required to be remitted or paid after 1987.

Subclause 67(4)

ITA 227(9.1)

New subsection 227(9.1) of the Act restricts the application of the penalty contained in subsection 227(9) for late or deficient remittances to the amount by which the total of the required remittance of source deductions and amounts required to be remitted under the *Canada Pension Plan* and the *Unemployment Insurance Act, 1971* for the particular period exceeds $500. This $500 threshold does not apply where the person required to remit such amounts has wilfully delayed in remitting or has wilfully remitted less than the required amount.

This amendment is applicable to remittances in respect of remuneration paid after 1987.

Communication of Information

Clause 68

Section 241 of the Act contains rules designed to ensure the confidentiality of information obtained by Revenue Canada, Taxation in administering the Act.

Subclause 68(1)

ITA
241(1)(c)

Section 241 of the Act sets out the prohibition against the unauthorized communication of information obtained by government officials in administering the tax system. The existing section does not, however, prohibit the personal or other use by an authorized official of any information obtained. The addition of new paragraph 241(1)(c) will expressly prohibit Revenue Canada employees and other government officials from making any unintended use of information obtained through the tax system. This amendment is applicable after the enabling legislation receives Royal Assent.

Subclause 68(2)

ITA
241(3)

Subsection 241(3) of the Act authorizes the disclosure of tax information in criminal proceedings. This exception to the general rule of confidentiality of tax information was intended to apply only after criminal charges had been laid. A recent court case, however, indicates that police forces and prosecutors may be able to demand information as soon as a criminal investigation has begun. The amendment to subsection 241(3) of the Act will clarify that tax information may be provided by Revenue Canada in criminal proceedings only following the laying of a criminal charge. This amendment is applicable after February 18, 1987.

Subclauses 68(3) and (4)

ITA
241(4) and (10)

Paragraph 241(4)(f) of the Act authorizes the communication of tax information obtained under the Act to federal government officials outside Revenue Canada, Taxation, for limited purposes . New subparagraph 241(4)(f)(iv) extends this authority to communicate information to officials of the Department of Regional Industrial Expansion for the purpose of the approval and certification requirements of the 60 per cent Cape Breton investment tax credit program. This amendment is effective after June 3, 1987.

New subparagraph 241(4)(f)(v), applicable to the 1982 and subsequent taxation years, authorizes the Minister of National Revenue to communicate information to the Department of Energy, Mines and Resources for the purpose of enabling that Department to calculate amounts payable by it to the provinces under the *Canada-Nova Scotia Oil and Gas Agreement Act*, the *Canada-Newfoundland Atlantic Accord Implementation Act* and similar statutes that relate to petroleum and gas exploration and exploitation in the offshore areas adjacent to the provinces. The new subparagraph also authorizes communication of this information to the provinces concerned.

Further amendments to paragraphs 241(10)(a) and (b) clarify that Revenue Canada, Taxation is permitted to communicate tax information to provincial governments to the extent required for the tax administration for which Revenue Canada, Taxation is responsible. These amendments are applicable after February 18, 1987.

Interpretation

Clause 69

ITA
248

Section 248 of the Act defines many of the terms used in the Act and contains a number of special rules for the purposes of applying other provisions of the Act.

Subclause 69(1)

ITA
248(1)
"employee benefit plan"

The definition of "employee benefit plan" is amended to exclude retirement compensation arrangements. This amendment, applicable after October 8, 1986, is consequential on the introduction of the new rules relating to such arrangements.

"taxable income"
"taxable income earned in Canada"

The definitions of "taxable income" and "taxable income earned in Canada" are revised effective for the 1985 and subsequent taxation years to ensure that a taxpayer may not have a negative taxable income or a negative taxable income earned in Canada. In some provisions of the Act, such as section 110.5 dealing with the special addition relating to the computation of the foreign tax credit, treating these amounts as being negative would produce unintended and inappropriate results.

Subclause 69(2)

ITA
248(1)
"retirement compensation arrangement"

The definition of "retirement compensation arrangement" (RCA) is added to subsection 248(1) of the Act. This definition is relevant to the new provisions, particularly new Part XI.3, relating to such arrangements.

An RCA is a plan or arrangement under which an employer makes payments to another person, called a custodian, in order that benefits may be paid to an employee or any other person after the employee retires or otherwise severs his employment with the employer. In the absence of this definition, such arrangements would ordinarily be employee benefit plans.

In addition to retirement and loss of office, an RCA may exist where benefits are paid as a consequence of "any substantial change in the services rendered" by an employee. This would include circumstances where the employee may not be completely retired – for example, where a former officer continues to be employed on a consulting basis but enjoys benefits under the arrangement or where a professional athlete is retained as a scout or coach or for public relations purposes after his playing career is ended.

The definition also specifically excludes an arrangement for a professional athlete that would be a salary deferral arrangement but for the exclusion in paragraph (j) of the definition of that expression provided that, in the case of such an arrangement for employees of a Canadian team, the custodian carries on business through a fixed place of business in Canada and is a trust company or other person authorized to offer to the public its services as trustee. The result is that such an arrangement will be treated as an employee benefit plan. There is a special rule in new subsection 207.6(4) where, because of a change of the residence of the custodian or in his circumstances, the plan ceases to qualify for this exclusion and thereby becomes an RCA.

Numerous arrangements are specifically excluded from the definition of an RCA by paragraphs (a) to (n) of the definition. Excluded are professional athlete arrangements as described above as well as the various "registered" plans and other plans and arrangements specifically dealt with in the Act. In addition, foreign pension and retirement benefit plans established primarily for the benefit of non-resident employees are excluded. However, special rules are provided in new subsection 207.6(5) where contributions are made to such plans for the benefit of employees resident in Canada. Insurance policies are also generally excluded, but reference should be made to new subsection 207.6(2) and the commentary thereunder. Paragraph (n) excludes prescribed plans from the definition. It is proposed to prescribe qualifying plans for on-ice officials of the National Hockey League. It is also proposed to prescribe the *Canada Pension Plan*, the plan established under the *Unemployment Insurance Act, 1971* and other similar statutory plans.

The definition also makes it clear that where a person is acting as trustee in respect of certain properties and, under the terms of the trust and any related arrangements, the plan or arrangement would be an RCA if the properties had been contributed to another party, then that arrangement will be treated as a retirement compensation arrangement of which the person is the custodian.

This definition is applicable after October 8, 1986; however, for plans that existed on that date, it will not apply before January 1, 1988 or such earlier date on which the existing plan is materially changed.

For the purposes of the provisions of the Act relating to retirement compensation arrangements, a plan that existed on October 8, 1986 will be treated as two separate plans at such time as the definition becomes applicable to it in accordance with the foregoing transitional rules. The two plans will consist of the new plan that comes into existence at that time and is treated as an RCA, and the original plan which is not an RCA.

Subclause 69(3)

ITA 248(7)

Subsection 248(7) of the Act provides that anything sent by mail is considered to have been received by the recipient on the day that it was mailed. This subsection is amended to exclude from this rule remittances to the Receiver General of amounts deducted or withheld under the Act or a regulation after 1987. These amounts will be considered to have been remitted on the day they were actually received by the Receiver General. In addition, in order for an item to be considered to have been received on the date of its mailing, the item must be sent by first class mail or its equivalent. For this purpose, it is intended that courier services be considered equivalent to first class mail, provided the item is entrusted to the courier service for prompt delivery in the normal course. This latter amendment is applicable to anything sent after 1987.

Taxation Year

Clause 70

ITA 249(4)

New subsection 249(4) of the Act treats a corporation's taxation year that would otherwise have included the time when control of the corporation is acquired by a person or group of persons as having ended immediately before that time. This will give rise to all the consequences which normally follow a taxation year-end, such as the filing of the corporate tax return and the payment of taxes due. Where the corporation had a taxation year more than seven days long that ended (otherwise than on a corporate emigration, a bankruptcy or a change in tax-exempt status) not more than seven days before the acquisition of control, the corporation may elect in its tax return for that year to extend that year so that it ends immediately before the acquisition of control. By such an election, the corporation can avoid having an additional taxation year in the period before the acquisition of control.

A new taxation year of the corporation is considered to have commenced at the time when control is acquired, and starting with that new taxation year, the corporation may adopt a new fiscal period.

The purpose of this new subsection is to require a separate determination of the income or loss of the corporation for the period ending immediately before the acquisition of control in order that the loss carry-over restrictions set out in section 111 can be applied to losses realized and accrued up to the time of acquisition of control. Subsection 249(4) is applicable with respect to acquisitions of control occurring after January 15, 1987 other than acquisitions of control occurring before 1988 where the persons acquiring the control were obliged on January 15, 1987 to acquire the control pursuant to agreements in writing entered into on or before that date.

Acquisition of Control

Clause 71

ITA 256

Section 256 of the Act contains rules for determining whether or not there has been an acquisition of control of a corporation for the purposes of certain provisions of the Act.

Subclause 71(1)

ITA 256(7)

Subsection 256(7) of the Act describes those circumstances where control of a corporation is considered not to have been acquired for the purposes of the loss and other carry-over provisions of the Act.

This subsection is amended, effective after January 15, 1987, to provide that it also applies for the purposes of:

- the new rules in section 37, concerning the tax treatment of scientific research and experimental development expenditures,
- the new rules in subsections 13(24) and 66(11.4) and (11.5) that apply in certain cases where a depreciable or resource property has been acquired by a corporation prior to a change of control, and
- the rule in new subsection 249(4) which requires a corporation to have a taxation year-end immediately before a change of control.

Subsection 256(7) is amended, effective for taxation years ending after February 17, 1987:

- to provide that it also applies for the purposes of the new change of control rules for resource expenses in new subsections 66.7(10) and (11), and
- to delete the reference to repealed subsection 66(11.1) which formerly provided a change of control rule for resource expenses.

Subsection 256(7) is also amended, effective after June 3, 1987, to provide that it also applies for the purposes of the new change of control rule in subsection 66.5(3) for the deduction with respect to a corporation's cumulative offset account.

Subclause 71(2)

ITA 256(8)

Subsection 256(8) of the Act extends the circumstances where an acquisition of control is considered to have occurred for the purposes of the rules relating to the carry-over of losses and certain other amounts.

This subsection is amended with respect to acquisitions of rights occurring after January 15, 1987 so that it also applies for the purposes of:

- the rules in amended section 37, concerning the tax treatment of scientific research and experimental development expenditures,

- the rules in new subsections 13(24) and 66(11.4) and (11.5) that apply in certain cases where a depreciable or resource property has been acquired by a corporation prior to a change of control, and

- the new rule in subsection 249(4) which requires a corporation to have a taxation year-end immediately before a change of control.

Subsection 256(8) is amended, with respect to acquisitions of rights occurring in taxation years ending after February 17, 1987:

- to provide that it also applies for the purposes of the new change of control rules for resource expenses in new subsections 66.7(10) and (11), and

- to delete the reference to repealed subsection 66(11.1) which formerly provided a change of control rule for resource expenses.

Subsection 256(8) is also amended, with respect to acquisitions of rights occurring after June 3, 1987, to provide that is also applies for the purposes of the new change of control rule in subsection 66.5(3) for the deduction with respect to a corporation's cumulative offset account.

Subclause 71(3)

ITA
256(9)

New subsection 256(9) of the Act, which is applicable after January 15, 1987, is relevant for the purposes of the amendments which restrict the carry-over of losses and other amounts after a change of control. Under this new subsection, the acquisition of control of a corporation on a day is treated as being at the commencement of that day unless the corporation elects not to have the subsection apply. Such an election would be made in the corporation's tax return for its taxation year ending immediately before the change of control.

Interpretation of Coming-into-force Provisions

Clause 72

Clause 72 provides a rule of interpretation for the coming-into-force provisions for a number of amendments relating to acquisitions and dispositions of property and changes of control. Those coming-into-force provisions provide grandfather treatment for acquisitions or dispositions by persons after January 15, 1987 and before 1988 where the persons were obliged on that date to make the acquisitions or dispositions pursuant to agreements in writing entered into on or before that date. The rule in this clause provides that for the purpose of those coming-into-force provisions, where a person may be excused from an obligation to make an acquisition or disposition as a result of changes to the Act affecting the acquisition or disposition, the person shall be considered not to have been obliged to make the acquisition or disposition. In that case, the acquisition or disposition will not be grandfathered.

Income Tax Application Rules, 1971

Clause 73

ITAR
29(25), (25.1) and (29)

Subsections 29(25) and (29) of the *Income Tax Application Rules, 1971* are the first and second successor corporation rules that allow resource expenses incurred by a person before 1972 to be deducted by a corporation (the "first successor corporation") that acquired all or substantially all of the Canadian resource properties of that person or by another corporation (the "second successor corporation") that acquired all or substantially all of the Canadian resource properties of the first successor corporation. The successor and second successor corporation rules in the *Income Tax Act* for resource expenses incurred after 1971 are replaced by a new successor corporation rule in new section 66.7 of the Act that accommodates any number of successions. The first and second successor rules in subsections 29(25) and (29) of the Rules are replaced, for taxation years ending after February 17, 1987, with new successor rules in amended subsection 29(25). The new rules are similar to the new successor rules in section 66.7 of the Act, which are further explained in the commentary on section 66.7. New subsection 29(25.1) provides that certain terms used in new subsection 29(25) have the same meanings as assigned by subsection 66(15) of the Act.

Income Tax Application Rules, 1971

Clause 74

ITAR
30(1)

Subsection 30(1) of the *Income Tax Application Rules, 1971* defines certain expressions used in the *Income Tax Act*. As a consequence of the amendments to the Act which introduce new successor corporation rules for resource expenses, these expressions are no longer necessary, so subsection 30(1) of the Rules is repealed for taxation years ending after February 17, 1987.

Canada Pension Plan

Clauses 75 and 76

CPP
24(2)

Subsection 24(2) of the *Canada Pension Plan* makes certain provisions of the *Income Tax Act* applicable for the purposes of the *Canada Pension Plan*. The subsection is amended to include references to subsections 161(11), 227(10), 227(9.1) and 248(7) of the *Income Tax Act*. The reference to subsection 161(11) permits the levying of interest on penalties. The reference to subsection 227(10) permits Revenue Canada, Taxation to issue an assessment against a third party who has ignored a garnishment order and to employ all the measures included in Divisions I and J of the *Income Tax Act* to recover such an amount. This amendment also ensures that, with respect to the remittance of CPP contributions, the exemption contained in new subsection 227(9.1) of the *Income Tax Act* from the penalty for late or deficient remittances of amounts up to $500 of source deductions, CPP contributions and U.I. premiums will apply. In addition, the reference to subsection 248(7) of the *Income Tax Act* relating to the time of the receipt of amounts means that CPP remittances must be received by the Receiver General on or before the due date.

CPP 37

Section 37 of the *Canada Pension Plan* makes certain provisions of the *Income Tax Act* applicable to contributions with respect to self-employed earnings. Section 37 is amended to include a reference to penalties and to subsections 248(7) and (11) of the *Income Tax Act*. The reference to penalties ensures that interest under subsection 161(11) of the *Income Tax Act* may be charged on penalties under the CPP and the reference to subsection 248(7) ensures that contributions in respect of self-employed earnings must be received by the Receiver General on or before the due date. The reference to subsection 248(11) ensures that interest may be computed and compounded daily.

Unemployment Insurance Act, 1971

Clauses 77 and 78

UIA 80

Section 80 of the *Unemployment Insurance Act, 1971* makes certain provisions of the *Income Tax Act* applicable for the purposes of the *Unemployment Insurance Act, 1971*. Section 80 is amended to include references to subsections 161(11), 227(9.1), 227(10) and 248(7) of the *Income Tax Act*. The reference to subsection 161(11) permits the levying of interest on penalties. The reference to subsection 227(10) permits Revenue Canada, Taxation to issue an assessment against a third party who has ignored a garnishment order and to employ all the measures included in Divisions I and J of the *Income Tax Act* to recover the amount. This amendment also ensures that, with respect to the remittance of U.I. premiums, the exemption contained in new subsection 227(9.1) of the *Income Tax Act* from the penalty for late or deficient remittance of amounts up to $500 of source deductions, CPP contributions and U.I. premiums will apply. In addition, the reference to subsection 248(7) of the *Income Tax Act* relating to the time of the receipt of amounts means that U.I. premiums must be received by the Receiver General on or before the due date.

UIA 145

Section 145 of the *Unemployment Insurance Act, 1971* makes certain provisions of the *Income Tax Act* applicable for the purposes of Part VIII of the U.I. Act. Section 145 is amended to include references to subsections 161(11), 227(10) and 248(7) and (11) of the *Income Tax Act*. The reference to subsection 161(11) ensures that interest may be charged on penalties. The reference to subsection 227(10) permits Revenue Canada, Taxation to issue an assessment against a third party who has ignored a garnishment order and to employ all the measures included in Divisions I and J of the *Income Tax Act* to recover the amount. The reference to subsection 248(7) ensures that repayments of benefits must be received by the Receiver General on or before the due date. The reference to subsection 248(11) ensures that interest may be computed and compounded daily.

Appendix I

Draft Income Tax Regulations

1. The definition "remuneration" in subsection 100(1) of the *Income Tax Regulations* is amended by adding thereto, immediately after paragraph (b) thereof, the following paragraph:

"(b.1) a distribution to one or more persons out of or under a retirement compensation arrangement;"

2. Section 103 of the said Regulations is amended by adding thereto the following subsection:

"(7) For the purposes of subsection 153(1) of the Act, the amount to be deducted or withheld by a person

(a) from any contribution made by him under a retirement compensation arrangement, other than a contribution made by him as an employee, or

(b) from any payment by him to a resident of Canada of an amount on account of the purchase price of an interest in a retirement compensation arrangement

shall be 50 percent of the contribution or payment, as the case may be."

3. (1) Section 108 of the said Regulations is amended by adding thereto, immediately after subsection (1) thereof, the following subsections:

"(1.1) Notwithstanding subsection (1), where the average monthly withholding amount of an employer for the second calendar year preceding a particular calendar year is not less than $15,000, amounts deducted or withheld from payments described in paragraphs (a) or (m) of the definition "remuneration" in subsection 100(1) made in the particular calendar year by the employer shall be remitted to the Receiver General

(a) for payments made before the 16th day of a month, on or before the 25th day of the month; and

(b) for payments made after the 15th day of a month, on or before the 10th day of the following month.

(1.2) For the purposes of this section, "average monthly withholding amount" of an employer for a particular calendar year is the quotient obtained when

(a) the aggregate of all amounts each of which is an amount required to be remitted with respect to the particular year under

(i) subsection 153(1) of the Act and a similar provision of a law of a province which imposes a tax upon the income of individuals where the province has entered into an agreement with the Minister of Finance for the collection of taxes payable to the province, in respect of payments described in paragraphs (a) or (m) of the definition "remuneration" in subsection 100(1),

(ii) subsection 22(1) of the *Canada Pension Plan*, or

(iii) subsection 68(1) of the *Unemployment Insurance Act, 1971*

by the employer and, where the employer is a corporation, by each corporation associated with the corporation in a taxation year of the employer ending in the second calendar year following the particular year

is divided by

(b) the number of months in the particular year, not exceeding twelve, for which such amounts were required to be remitted by the employer and, where the employer is a corporation, by each corporation associated with it in a taxation year of the employer ending in the second calendar year following the particular year.

(1.3) For the purposes of subsection (1.2), where a particular employer that is a corporation has acquired in a taxation year of the corporation ending in a particular calendar year all or substantially all of the property of another employer used by the other employer in a business

(a) by virtue of an amalgamation (within the meaning assigned by section 87 of the Act),

(b) as the result of a winding-up in respect of which subsection 88(1) of the Act is applicable, or

(c) in a transaction in respect of which an election was made under subsection 85(1) or (2) of the Act,

the other employer shall be deemed to be a corporation associated with the particular employer in the taxation year and each taxation year ending at any time in the next two following calendar years."

(2) Subsection 108(4) of the said Regulations is revoked.

4. Paragraph 200(2)(a) of the said Regulations is revoked and the following substituted therefor:

"(a) a scholarship, fellowship or bursary, or a prize for achievement in a field of endeavour ordinarily carried on by the recipient thereof (other than a prize prescribed by section 7400);"

5. (1) Subsection 304(1)[1] of the said Regulations is revoked and the following substituted therefor:

"(1) For the purposes of this Part and subsection 12.2(3) of the Act, a prescribed annuity contract for a taxation year means

(a) an annuity contract purchased pursuant to a registered pension plan, a registered retirement savings plan, a deferred profit sharing plan, a plan referred to in subsection 147(15) of the Act as a "revoked plan" or an annuity contract described in paragraph 148(1)(c) or (e) of the Act; or

(b) an annuity contract

(i) under which payments have commenced in the year or a previous year,

(ii) issued by a corporation described in any of paragraphs 39(5)(b) to (d) or clause 146(1)(j)(ii)(B) of the Act, a life insurance corporation, a registered charity or any other

[1] SOR/83-865, 1983 *Canada Gazette*, Part II, p. 4179

corporation (other than a mutual fund corporation or a mortgage investment corporation) whose principal business is the making of loans (in this section referred to as an "issuer"),

(iii) the holder of which is an individual who

(A) is the annuitant under the contract, and

(B) throughout the year dealt at arm's length with the issuer,

(iv) the terms and conditions of which require that from the time the annuity contract becomes a prescribed annuity contract

(A) all payments to be made out of the contract will be equal annuity payments made at regular intervals but not less frequently than annually, subject to the holder's right to vary the frequency and quantum of payments to be made out of the contract in any year without altering the present value at the beginning of the year of the total payments to be made in that year out of the contract,

(B) the annuity payments thereunder will continue for a fixed term, for the life of the holder or for the lives jointly of the holder and any one of the holder's spouse, brothers and sisters (referred to in this subparagraph as "the survivor"),

(C) where there is a guarantee in respect of the term over which annuity payments are to be paid or a fixed term, the guaranteed or fixed term will not extend beyond the time at which the holder, or in the case of a joint life annuity, the younger of the holder and the survivor would, if that younger person survived, attain the age of 91 years,

(D) no loans will exist under the contract and the holder's rights under the contract cannot be disposed of otherwise than on the holder's death, and

(E) no payments will be made out of the contract other than as permitted by this section,

(v) none of the terms and conditions of which provide for any recourse against the issuer for failure to make any payment under the contract, and

(vi) in respect of which a holder thereof has not notified the issuer in writing, before the end of the year in which the annuity contract was issued, that the annuity contract is not to be treated as a prescribed annuity contract."

(2) Section 304[1] of the said Regulations is further amended by adding thereto the following subsection:

"(3) In this section,

(a) "annuitant" under an annuity contract, at any time, means the person who, at that time, is entitled to receive annuity payments under the contract; and

(b) the annuitant under an annuity contract is deemed to be the holder of the contract where

[1] SOR/83-865, 1983 *Canada Gazette*, Part II, p. 4179

(i) it is held by another person in trust for the annuitant, or

(ii) it was acquired by the annuitant under a group term life insurance policy under which life insurance was effected on the life of another person in respect of, in the course of, or by virtue of the office or employment or former office or employment of that other person."

6. (1) Paragraph 1100(2.2)(a) of the said Regulations is revoked and the following substituted therefor:

"(a) in a transaction in respect of which an election was made under subsection 85(1) or (2), 97(2) or 98(3) or section 115.1 of the Act,"

(2) Paragraph 1100(19)(a) of the said Regulations is revoked and the following substituted therefor:

"(a) in a transaction in respect of which an election was made under subsection 85(1) or (2), 97(2) or 98(3) or section 115.1 of the Act,"

7. Paragraph 1101(lad)(a) of the said Regulations is revoked and the following substituted therefor:

"(a) in a transaction in respect of which an election was made under subsection 85(1) or (2), 97(2) or 98(3) or section 115.1 of the Act,"

8. Paragraph 1102(14)(a) of the said Regulations is revoked and the following substituted therefor:

"(a) in a transaction in respect of which an election was made under subsection 85(1) or (2), 97(2) or 98(3) or section 115.1 of the Act,"

9. Section 1801 of the said Regulations is revoked and the following substituted therefor:

"1801. Except as provided in section 1802, for the purpose of computing the income of a taxpayer from a business all the property described in all the inventories of the business may be valued at its fair market value."

10. Paragraph 2400(3)(b) of the said Regulations is revoked and the following substituted therefor:

"(b) a transaction in respect of which an election was made under subsection 85(1) or (2) or section 115.1 of the Act, or"

11. (1) Subsection 5000(1) of the said Regulations is amended by replacing the word "cost" wherever it occurs in paragraph (e) thereof with the phrase "cost amount".

(2) Subsection 5000(2) of the said Regulations is amended by replacing the word "cost" wherever it occurs in paragraphs (a) and (b) thereof with the phrase "cost amount".

(3) Section 5000 of the said Regulations is amended by adding thereto, immediately after subsection (1.1) thereof, the following subsection:

"(1.2) For the purposes of paragraph (i) of the definition "foreign property" in subsection 206(1) of the Act, an interest of a beneficiary under a trust described in paragraph 149(1)(o.4) is hereby prescribed not to be foreign property of the beneficiary at any time where

(a) the beneficiary does not own any foreign property, determined without reference to this subsection, at that time, or

(b) the trust does not own any foreign property at that time."

(4) Part L of the said Regulations is further amended by adding thereto the following section:

"5001. For the purposes of paragraph 149(1)(o.4) of the Act, a trust is a master trust at any time if, at all times after it was created and before that time,

(a) it was resident in Canada;

(b) its only undertaking was the investing of its funds;

(c) it has never borrowed money nor accepted deposits; and

(d) all the beneficiaries of the trust were registered pension funds or plans."

12. Part LXII of the said Regulations is amended by adding thereto the following section:

"6207. (1) For the purposes of paragraph 183.1(4)(c) of the Act, a share is a prescribed share of the capital stock of an acquiring corporation where, at the time the share is issued

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

(i) the amount of the dividends (in this section referred to as the "dividend entitlement") that the corporation may declare or pay on the share is not limited to a maximum amount or fixed at a minimum amount at that time or at any time thereafter by way of a formula or otherwise,

(ii) the amount (in this section referred to as the "liquidation entitlement") that the holder of the share is entitled to receive on the share on the dissolution, liquidation or winding-up of the corporation is not limited to a maximum amount or fixed at a minimum amount by way of a formula or otherwise,

(iii) the share cannot be converted into any other security, other than into another security of the corporation or of another corporation with which it does not deal at arm's length that is, or would be at the date of conversion, a prescribed share,

(iv) the holder of the share does not, at that time or at any time thereafter, have the right or obligation to cause the share to be redeemed, acquired or cancelled by the corporation or any specified person in relation to the corporation, except where the redemption, acquisition or cancellation is required pursuant to a conversion that is not prohibited by subparagraph (iii),

(v) no person or partnership has, either absolutely or contingently, an obligation to reduce, or to cause the corporation to reduce, at that time or at any time thereafter, the paid-up capital in respect of the share, otherwise than by way of a redemption, acquisition or cancellation of the share that is not prohibited by this section, and

(vi) neither the corporation nor any specified person in relation to the corporation has, either absolutely or contingently, the right or obligation to redeem, acquire or cancel, at that time or at any time thereafter, the share in whole or in part, except where the redemption, acquisition or cancellation is required pursuant to a conversion that is not prohibited by subparagraph (iii); and

(b) it cannot reasonably be expected, having regard to all the circumstances, that any of the terms or conditions of the share or any existing agreement in respect of the share or its issue will be modified or amended, or that any new agreement in respect of the share or its issue will be entered into, in such a manner that the share would not be a prescribed share if it had been issued at the time of such modification or amendment or at the time the new agreement is entered into.

(2) For the purposes of this section,

(a) the dividend entitlement of a share of the capital stock of a corporation shall be deemed not to be limited to a maximum amount or fixed at a minimum amount where it may reasonably be considered that all or substantially all the dividend entitlement is determinable by reference to the dividend entitlement of another share of the capital stock of the corporation that meets the requirements of subparagraph (1)(a)(i);

(b) the liquidation entitlement of a share of the capital stock of a corporation shall be deemed not to be limited to a maximum amount or fixed at a minimum amount where it may reasonably be considered that all or substantially all of the liquidation entitlement is determinable by reference to the liquidation entitlement of another share of the capital stock of the corporation that meets the requirements of subparagraph (1)(a)(ii);

(c) where at any particular time after June 3, 1987, the terms or conditions of a share are changed or any existing agreement in respect thereof is changed or a new agreement in respect of the share is entered into, the share shall, for the purpose of determining whether it is a prescribed share, be deemed to have been issued at that particular time;

(d) a reference in subparagraphs (1)(a)(iv) and (vi) to a right or obligation of the corporation or a person or partnership does not include a right or obligation with respect to an acquisition described in subparagraph 183.1(4)(c)(i) or (ii) of the Act but includes such a right or obligation where any portion of the amount payable on the redemption, acquisition or cancellation of a share is directly determinable by reference to the profits of the corporation or of another corporation with which it does not deal at arm's length for the period the holder owned the share or had a right to acquire the share; and

(e) a reference in subparagraphs (1)(a)(iv) and (vi) to a right or obligation of the corporation or a person or partnership does not include a right or obligation provided in a written agreement among shareholders of a private corporation owning more than 50% of its issued and outstanding share capital having full voting rights under all circumstances to which the corporation, person or partnership is a party unless it may reasonably be considered having regard to all the circumstances, including the terms of the agreement and the number and relationship of the shareholders, that one of the main reasons for the existence of the agreement is to avoid or limit the application of subsection 183.1(1) of the Act.

(3) For the purposes of subsection (1), "specified person" in relation to a corporation means any person or partnership with whom the corporation does not deal at arm's length or any partnership or trust of which the corporation (or a person or partnership with whom the corporation does not deal at arm's length) is a member or beneficiary, respectively."

13. (1) All that portion of section 6700[2] of the said Regulations preceding paragraph (a) thereof is revoked and the following substituted therefor:

"6700. For the purposes of paragraph 40(2)(i), clause 53(2)(k)(i)(C), paragraph 125(7)(b), section 186.2 of the Act and in this Part and Part LI, "prescribed venture capital corporation" at any time means"

(2) Paragraph (a)[3] of section 6700 of the said Regulations is amended by deleting the word "or" at the end of subparagraph (v) thereof, by adding the word "or" at the end of subparagraph (vi) thereof and by adding thereto the following subparagraph:

"(vii) *An Act Respecting Quebec Business Investment Companies*, Statutes of Québec 1985, c.9;"

(3) Section 6700 of the said Regulations is amended by adding the word "or" at the end of paragraph (b) thereof and by adding thereto the following paragraph:

"(c) a corporation that is at that time registered with the Department of Economic Development and Tourism of the Government of the Northwest Territories pursuant to the Venture Capital Policy and Directive established by the Government of the Northwest Territories on June 27, 1985".

(4) Part LXVII of the said Regulations is further amended by adding thereto the following section:

"6704. For the purposes of section 186.2 of the Act, a corporation is a qualifying corporation with respect to dividends received by a shareholder on shares of its capital stock if, when the shares were acquired by the shareholder, they constituted

(a) a qualified investment under the provisions of an Act referred to in subparagraph 6700(a)(i) or (vii);

(b) an eligible investment under the provisions of an Act referred to in subparagraph 6700(a)(ii), (iv), (v) or (vi) or the regulation referred to in subparagraph 6700(1)(a)(iii), or

(c) an investment in an eligible business under the Venture Capital Policy and Directive referred to in paragraph 6700(c)."

14. Part LXVIII of the said Regulations is amended by adding thereto the following section:

"6801. For the purpose of paragraph (n) of the definition "retirement compensation arrangement" in subsection 248(1) of the Act, a prescribed plan or arrangement is

(a) the plan under the *Canada Pension Plan*;

(b) a provincial pension plan as defined in section 3 of the *Canada Pension Plan*;

[2] SOR/86-488, 1986 *Canada Gazette*, Part II, p. 2025

[3] SOR/86-379, 1986 *Canada Gazette*, Part II, p. 1612

(c) a plan under the *Unemployment Insurance Act, 1971*; and

(d) a plan pursuant to an agreement in writing that is established for the purpose of deferring the salary or wages of a professional on-ice official for his services as such with the National Hockey League if, in the case of an official resident in Canada, the trust or other person who has custody and control of any funds, investments or other property under the plan is resident in Canada."

15. The said Regulations are further amended by adding thereto the following Part:

"PART LXXIV
PRESCRIBED PRIZES

7400. For the purposes of subparagraph 56(1)(n)(i) of the Act, a prescribed prize is any prize which is recognized by the general public and which is awarded for meritorious achievement in the arts, sciences or service to the public but does not include any amount that can reasonably be regarded as having been received as compensation for services rendered or to be rendered."

16. The said Regulations are further amended by adding thereto the following Part:

"PART LXXV
PRESCRIBED PROVINCIAL PENSION PLANS

7500. (1) For the purposes of clause 56(1)(a)(i)(C), and paragraphs 60(v) and 110.2(4)(h), a prescribed provincial pension plan means the Saskatchewan Pension Plan.

(2) For the purpose of subparagraph 60(v)(ii) of the Act, the prescribed amount for the year in respect of the Saskatchewan Pension Plan is, for 1987, $1,200, and for 1988 and subsequent taxation years, $600."

17. The said Regulations are further amended by adding thereto the following Part:

"PART LXXVI
PRESCRIBED TAX TREATY PROVISIONS AND ELECTION

7600. (1) For the purposes of section 115.1 of the Act, paragraph 8 of Article XIII of the *Canada-United States Income Tax Convention (1980)* is a prescribed tax treaty provision.

(2) The election described in paragraph 115.1(b) of the Act in respect of a disposition of property may be made

(a) at any time, if the vendor and the purchaser of the property have filed with the Minister a waiver in respect of the disposition in the form prescribed for the purposes of subparagraph 152(4)(a)(ii) of the Act within 3 years from the day that the Minister, by virtue of subsection 152(2) or (4) of the Act, mails to the vendor a notice of an original assessment or a notification that no tax is payable, for the taxation year of the vendor in which he disposed of the property; and

(b) within 3 years from the day referred to in paragraph (a), in any other case."

18. (1) Sections 1 and 2 are applicable after March 27, 1987.

(2) Subsection 3(1) is applicable in respect of amounts deducted or withheld from payments made after 1987.

(3) Subsection 3(2) is applicable with respect to taxation years commencing after 1986.

(4) Sections 4 and 15 are applicable to the 1983 and subsequent taxation years.

(5) Section 5 is applicable to 1987 and subsequent taxation years except that, in respect of annuity contracts under which payments have commenced before 1987, section 5 applies only to taxation years ending on or after the date on which the holder of the contract notifies the issuer of the contract in writing that the contract is to be treated as a prescribed annuity contract.

(6) Section 9 is applicable in valuing the cost to a taxpayer of the property described in an inventory of a business of the taxpayer at any time after January 15, 1987.

(7) Sections 6, 7, 8, 10 and 17 are applicable to taxation years commencing after 1984.

(8) Subsections 11(3) and (4) and section 16 are applicable to the 1987 and subsequent taxation years.

(9) Section 12 is applicable after November 27, 1986.

(10) Subsection 13(1) is applicable to taxation years ending after February 18, 1987.

(11) Subsections 13(2) and (3) are applicable to 1986 and subsequent taxation years.

(12) Subsection 13(4) is applicable with respect to dividends received after February 18, 1987.

(13) Section 14 is applicable after October 8, 1986.

Appendix II

Draft Canada Pension Plan Regulations

1. Section 8 of the *Canada Pension Plan Regulations* is amended by adding thereto, immediately after subsection (1) thereof, the following subsections:

"(1.1) Notwithstanding subsection (1), where the average monthly withholding amount for an employer for the second calendar year preceding a particular calendar year is not less than $15,000, the employee's contribution and the employer's contribution shall be remitted to the Receiver General

(a) in respect of remuneration paid before the 16th day of a month in the particular year, on or before the 25th day of the month; and

(b) in respect of remuneration paid after the 15th day of a month in the particular year, on or before the 10th day of the following month.

(1.2) For the purpose of this section, "average monthly withholding amount" of an employer for a calendar year has the meaning assigned by subsection 108(1.2) of the *Income Tax Regulations*."

2. Section 1 is applicable for remittances in respect of remuneration paid after 1987.

Appendix III

Draft Unemployment Insurance (Collection of Premiums) Regulations

1. Section 4 of the *Unemployment Insurance (Collection of Premiums) Regulations* is amended by adding thereto, immediately after subsection (3) thereof, the following subsections:

> "(3.1) Notwithstanding subsection (3), where the average monthly withholding amount of an employer for the second calendar year preceding a particular calendar year is not less than $15,000, the employer shall remit employees' premiums and the employer's premiums payable under the Act and these Regulations to the Receiver General
>
> (a) in respect of remuneration or other insurable earnings paid before the 16th day of a month in the particular year, on or before the 25th day of the month; and
>
> (b) in respect of remuneration or other insurable earnings paid after the 15th day of a month in the particular year, on or before the 10th day of the following month.
>
> (3.2) For the purposes of this section "average monthly withholding amount" of an employer for a calendar year has the meaning assigned by subsection 108(1.2) of the *Income Tax Regulations.*"

2. Section (1) is applicable for remittances in respect of remuneration or other insurable earnings paid after 1987.