
Draft Legislation, Regulations and Explanatory Notes Respecting Preferred Share Financing

The Honourable Michael H. Wilson
Minister of Finance

April 1988

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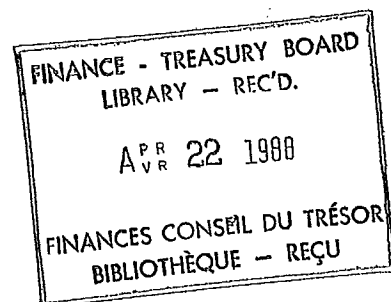
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Department of Finance
Canada

Ministère des Finances
Canada



Draft Legislation

Preferred Shares

DRAFT LEGISLATION
PREFERRED SHARES

1.(1) Subsection 82(2) of the Income Tax Act is repealed and the following substituted therefor:

Dividends received

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

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

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

Deemed dividend on term preferred share

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

(a) a specified financial institution, or

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

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

Deemed dividend on taxable preferred shares

(4.3) Where at any time after 1987 the paid-up capital in respect of a taxable preferred share of the capital stock of a corporation was reduced otherwise than by way of a redemption, acquisition or cancellation of the share or of a transaction described in subsection (2) or (4.1), the amount paid on the reduction of the paid-up capital in respect of the share shall be deemed to be a dividend on the share

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

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

Deemed dividend on taxable RFI shares

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

(a) a restricted financial institution, or

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

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

Deemed Dividend on Guaranteed Share

(4.5) Where at any time after 1987 the paid-up capital in respect of a share owned by a corporation to which subsection 112(2.2) would apply to deny the deduction under subsection 112(1), (2) or 138(6) of a dividend received on the share was reduced otherwise than by way of a redemption, acquisition or cancellation of the share or of a transaction described in subsection (2) or (4.1), the amount received by the shareholder on the reduction of the paid-up capital in respect of the share shall be deemed to be a dividend received by the shareholder at that time." -

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

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

Tax on taxable preferred shares

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

Transferred liability for Part VI.1 tax

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

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

Idem

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

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

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

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

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

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

Exchanged Rights

(4.3) Where there has been an amalgamation or merger of two or more corporations after June 18, 1987 and a right listed on a prescribed stock exchange to acquire a share of any class of the capital stock of the new corporation (in this subsection referred to as the "new right") was acquired by a shareholder in consideration for the disposition of a right described in paragraph (d) of the definition "grandfathered share" to acquire a share of any class of the capital stock of a predecessor corporation (in this subsection referred to as the "exchanged right"), the new right shall be deemed to be the same right as the exchanged right for the purposes of paragraph (d) of the definition "grandfathered share" where the terms and conditions of the new right were the same as, or substantially the same as, the terms and conditions of the exchanged right and the terms and conditions of the share receivable upon an exercise of the new right were the same as, or substantially the same as, the terms and conditions of the share that would have been received upon an exercise of the exchanged right." -

(3) Subsection 87(4.3) of the said Act, as enacted by subsection (2), and subsection (1) are applicable to amalgamations occurring after June 18, 1987.

(4) Subsection 87(4.2) of the said Act, as enacted by subsection (2), is applicable to amalgamations and mergers occurring after November 27, 1986.

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

"(e.2) paragraphs 87(2)(c), (d.1), (e.1), (g) to (1), (1.3) to (u), (x), (y.1), (z.1), (cc), (11) to (nn), (pp) and (rr), subsection 87(6) and, subject to section 78, subsection 87(7) apply to the winding-up as if the references therein to"

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

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

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

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

5.(1) Subsection 104(19) of the said Act is repealed and the following substituted therefor:

Dividends Deemed Received by Beneficiary

"(19) Such portion of a taxable dividend received by a trust in a taxation year on a share of the capital stock of a taxable Canadian corporation as

(a) may reasonably be considered (having regard to all the circumstances including the terms and conditions of the trust arrangement) to be part of the amount that, by virtue of subsection (13) or (14) or section 105, as the case may be, was included in computing the income for a particular taxation year of a beneficiary under the trust, and

(b) was not designated by the trust in respect of any other beneficiary thereunder

shall, if so designated by the trust in respect of the beneficiary in the return of its income for the year under this Part, be deemed, for the purposes of this Act, other than Part XIII, not to have been received by the trust and to be a taxable dividend on the share received by the beneficiary in the particular year from the corporation."

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

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

Part VI.1 tax

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

(2) Subsection (1) is applicable to the 1988 and subsequent taxation years except that in the application of paragraph 110(1)(k) of the said Act, as enacted by subsection (1), to taxation years ending before July, 1988 the reference therein to "5/2 of" shall be read as a reference to "2 times".

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

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

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

"(b) such portion of the corporation's non-capital loss or farm loss, as the case may be, for a taxation year ending after that time as may reasonably be regarded as its loss from carrying on a business and, where a business was carried on by the corporation in that year, such portion of the non-capital

loss as may reasonably be regarded as being in respect of an amount deductible under paragraph 110(1)(k) in computing its taxable income for the year is deductible by the corporation for a particular year ending before that time"

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

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

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

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

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

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

exceeds

(ii) 1/5 of the lesser of

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

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

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

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

(ii) 1/4 of the lesser of

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

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

(c) for the purpose of subsection 111(3) of the said Act the aggregate of all amounts each of which is an amount deducted in computing a corporation's taxable income or an amount claimed under Part IV of the said Act for a taxation year ending before July, 1988 in respect of a non-capital loss for another taxation year ending after June, 1988 shall be deemed to be the aggregate of

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

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

(A) all the amounts so deducted or so claimed

exceeds

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

8.(1) Subsection 112(2.1) of the said Act is repealed and the following substituted therefor:

Where no deduction permitted

"(2.1) No deduction may be made under subsection (1) or (2) in computing the taxable income of a specified financial institution in respect of a dividend received by it on a share that was, at the time the dividend was paid, a term preferred share, other than a dividend paid on a share of the capital stock of a corporation that was not acquired in the ordinary course of the business carried on by the institution, and for the purposes of this subsection, where a restricted financial institution received the dividend on a share of

the capital stock of a mutual fund corporation or an investment corporation at any time after that mutual fund corporation or investment corporation has elected pursuant to subsection 131(10) not to be a restricted financial institution, the share shall be deemed to be a term preferred share acquired in the ordinary course of business."

(2) Subsection 112(2.2) of the said Act is repealed and the following substituted therefor:

Idem

"(2.2) No deduction may be made under subsection (1), (2) or 138(6) in computing the taxable income of a particular corporation in respect of a dividend received on a share of the capital stock of a corporation that was issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 where a person or partnership (other than the issuer of the share or an individual other than a trust) that is a specified financial institution or a specified person in relation to any such institution was, at or immediately before the time the dividend was paid, obligated, either absolutely or contingently and either immediately or in the future, to effect any undertaking (in this subsection referred to as a "guarantee agreement"), including any guarantee, covenant or agreement (including the lending of funds to or the placing of amounts on deposit with, or on behalf of, the particular corporation or any specified person in relation to the particular corporation) to purchase or repurchase the share given to ensure that

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

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

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

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

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

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

and for the purposes of this subsection

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

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

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

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

Related corporations

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

(5) Subsection (1) is applicable with respect to dividends received after June 18, 1987.

(6) Subsection (2) is applicable with respect to dividends received on shares (other than grandfathered shares) issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 and on shares deemed by paragraph 112(2.2)(f) of the said Act, as enacted by subsection (2), to have been issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987.

(7) Subsection (3) is applicable with respect to dividends received on short-term preferred shares (other than grandfathered shares) issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987.

(8) Subsection (4) is applicable after 5.00 p.m. Eastern Standard Time, November 27, 1986.

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

Restricted Financial Institution

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

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

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

Deduction for dividends from taxable corporations

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

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

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

"(i) on or before the last day of each month in the year, the aggregate of an amount equal to 1/12 of the amount estimated by it to be the tax payable under this Part by it for the year computed without reference to sections 127.2 and 127.3 and an amount equal to 1/12 of the amount estimated by it to be the tax payable under Part VI.1 by it for the year,"

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

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

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

"and for the year or the immediately preceding taxation year

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

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

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

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

Idem

"(2.1) Where

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

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

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

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

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

Special case

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

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

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

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

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

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

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

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

"(b) all amounts, each of which is an amount in respect of a taxable dividend, in respect of which an amount is deductible under subsection 112(1) from its income for the year, received by the particular corporation in the year from a corporation (in this section referred to as the "payer corporation") connected with the particular corporation equal to that proportion of"

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

Reduction in tax

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

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

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

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

Partnerships

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

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

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

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

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

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

- "PART IV.1

TAXES ON DIVIDENDS ON CERTAIN PREFERRED SHARES RECEIVED BY CORPORATIONS.

Definitions

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

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

(b) received by a corporation from another corporation (other than a corporation described in paragraphs (a) to (f) of the definition "financial intermediary corporation" in subsection 191(1)) in which it has or would have, if the other corporation were a taxable Canadian corporation, a substantial interest (as determined under section 191) at the time the dividend was paid,

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

(d) received by a corporation on a short-term preferred share of the capital stock of a taxable Canadian corporation other than a dividend described in paragraph (b) or (c) of the definition "excluded dividend" in subsection 191(1).

Tax on dividends on taxable preferred shares

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

Tax on dividends on taxable RFI shares

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

Time of acquisition of share

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

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

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

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

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

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

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

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

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

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

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

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

(f) where, at any particular time, there has been an amalgamation within the meaning assigned by section 87, and

(i) each of the predecessor corporations was a restricted financial institution throughout the period from 8:00 p.m. Eastern Daylight Savings Time, June 18, 1987 to the particular time and the predecessor corporations were related to each other throughout that period, or

(ii) each of the predecessor corporations and the new corporation is a corporation described in any of paragraphs (a) to (d) of the definition "restricted financial institution" in subsection 248(1),

a taxable RFI share acquired by the new corporation from a predecessor corporation on the amalgamation shall be deemed to have been acquired by the new corporation at the time it was acquired by the predecessor corporation.

Partnerships

187.4 For the purposes of this Part,

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

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

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

Information return

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

Provisions applicable to Part

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

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

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

- "PART VI.I

TAX ON CORPORATION PAYING DIVIDENDS ON TAXABLE PREFERRED SHARES

Definitions

191.(1) In this Part,

"excluded dividend"

"excluded dividend" means a dividend

(a) paid by a corporation to a shareholder that had a substantial interest in the corporation at the time the dividend was paid,

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

(c) paid by a particular corporation that would, but for paragraph (h) or (i) of the definition "financial intermediary corporation", have been a financial intermediary corporation at the time the dividend was paid, except where the dividend was

paid to a controlling corporation in respect of the particular corporation or to a specified person (within the meaning assigned by paragraph (h) of the definition "taxable preferred share" in subsection 248(1)) in relation to such a controlling corporation,

(d) paid by a mortgage investment corporation, or

(e) that is a capital gains dividend within the meaning assigned by subsection 131(1);

"financial intermediary corporation"

"financial intermediary corporation" means a corporation that is

- (a) a corporation described in clause 146 (1)(j)(ii)(B)
- (b) an investment corporation,
- (c) a mortgage investment corporation,
- (d) a mutual fund corporation,
- (e) a prescribed venture capital corporation, or
- (f) a prescribed labour-sponsored venture capital corporation,

but does not include

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

assigned by paragraph (h) of the definition "taxable preferred share" in subsection 248(1)) in relation to the other corporation do not own in aggregate shares of the capital stock of the particular corporation having a fair market value of more than 10% of the fair market value of all of the issued and outstanding shares of the capital stock of the particular corporation (such fair market values being determined without regard to any voting rights attaching to such shares);

"private holding corporation"

"private holding corporation" means a private corporation

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

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

but does not include

(c) a specified financial institution,

(d) any particular corporation that is controlled by or for the benefit of one or more corporations (other than corporations that would, but for such control of the particular corporation, be private holding corporations), or

(e) any particular corporation in which another corporation owns shares and has a substantial interest, except where the other corporation would, but for its substantial interest in the particular corporation, be a private holding corporation.

Substantial interest

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

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

(b) the shareholder owned, at that time,

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

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

(iii) shares (other than shares that would be taxable preferred shares if the definition "taxable preferred share" in subsection 248(1) were read without reference to subparagraph (b)(iv) thereof, and if they were issued after June 18, 1987 and were not grandfathered shares) of the capital stock of the corporation having a fair market value of 25% or more of the fair market value of all of such shares of the capital stock of the corporation,

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

Idem

(3) Notwithstanding subsection (2)

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

(b) where it may reasonably be considered, having regard to all the circumstances, that the principal purpose for an acquisition of a share of the capital stock of a corporation (in this paragraph referred to as the "issuer") by any person (in this paragraph referred to as the "acquiror") that had, immediately after the time of the acquisition, a substantial interest in the issuer from another person that did not, immediately before that time, have a substantial interest in the issuer, was to avoid or limit the application of this Part or Part IV.1 with respect to a dividend on the share, the acquiror and specified persons (within the meaning assigned by paragraph (h) of the definition "taxable preferred share" in

subsection 248(1)) in relation to the acquiror shall be deemed not to have a substantial interest in the issuer with respect to any dividend paid on the share;

(c) a corporation described in paragraphs (a) to (f) of the definition "financial intermediary corporation" in subsection (1) shall be deemed not to have a substantial interest in another corporation unless it is related (otherwise than by reason of a right referred to in paragraph 251(5)(b)) to the other corporation; and

(d) any partnership or trust other than

(i) a trust in which all persons who are beneficially interested, within the meaning assigned by subsection 94(7), are related to each other (otherwise than by reason of a right referred to in paragraph 251(5)(b)) and, for the purposes of this subparagraph, where a particular person who is so beneficially interested in the trust is an aunt, uncle, niece or nephew of another person, the particular person and any person who is a child or descendent of the particular person shall be deemed to be related to the other person and any person who is a child or descendant of the other person, and

(ii) a trust in which only one person is beneficially interested, within the meaning assigned by subsection 94(7),

shall be deemed not to have a substantial interest in a corporation.

Reorganizations

(4) Where a corporation issues a share of its capital stock at any time

(a) in the course of a reorganization, and the terms and conditions of the share or an agreement in respect of the share entered into as part of the reorganization provide that the share is to be redeemed, acquired or cancelled for a specified amount and it is reasonable to consider that the specified amount is equal to the fair market value at that time of the consideration for which the share is issued,

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

(c) for consideration that does not include a taxable preferred share of the corporation or a share of the capital stock of the corporation that is a term preferred share by reason of paragraph (b) of the definition "term preferred share" in subsection 248(1) or any right in respect thereto,

the amount of any dividend deemed to have been paid under subsection 84(2) or (3) on the redemption, acquisition or cancellation of the share of the corporation shall

(d) for the purposes of this Part and section 187.2 be deemed to be an excluded dividend or excepted dividend, as the case may be, and

(e) be deemed not to be a dividend to which subsection 112(2.1) or 138(6) applies to deny a deduction with respect to the dividend in computing the taxable income of the corporation under subsection 112(1) or (2) or 138(6),

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

Deemed dividends

(5) Where at any time

(a) the terms or conditions of a share of the capital stock of a corporation (other than a taxable preferred share or a share that is a term preferred share by reason of paragraph (b) of the definition "term preferred share" in subsection 248(1)) are changed or established, or

(b) an agreement in respect of a share of the capital stock of a corporation other than a taxable preferred share or a share that is a term preferred share by reason of paragraph (b) of the definition "term preferred share" in subsection 248(1) is changed or entered into

to provide for the redemption, acquisition or cancellation of the share for a specified amount and it is reasonable to consider that the specified amount is equal to the fair market value of the share immediately before that time, the amount of any dividend deemed to have been paid under subsection 84(2) or (3) on the redemption, acquisition or cancellation of the share shall

(c) for the purposes of this Part and section 187.2 be deemed to be an excluded dividend or excepted dividend, as the case may be, and

(d) be deemed not to be a dividend to which subsection 112(2.1) or 138(6) applies to deny a deduction with respect to the dividend in computing the taxable income of the corporation under subsection 112(1), (2) or 138(6),

unless the amount paid on the redemption, acquisition or cancellation of the share exceeds the specified amount.

Tax on taxable dividends

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

(a) the aggregate of

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

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

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

amount, if any, by which the corporation's dividend allowance for the year exceeds the aggregate of the dividends referred to in subparagraphs (i) and (ii), and

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

exceeds

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

Dividend allowance

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

(a) \$500,000

exceeds

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

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

Associated corporations

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

taxable Canadian corporations with which each such corporation is associated in the year, the dividend allowance for the year for each of the corporations is the amount so allocated to it.

Total dividend allowance

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

(a) \$500,000

exceeds

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

Failure to file agreement

(5) If any of the taxable Canadian corporations that are associated with each other in a taxation year and that have paid taxable dividends (other than excluded dividends) on taxable preferred shares in the year has failed to file with the Minister an agreement as contemplated by subsection (3) within 30 days after notice in writing by the Minister has been forwarded to any of them that such an agreement is required for the purpose of any assessment of tax under this Part, the Minister shall, for the purpose of this section, allocate an amount to one or more of them for the taxation year, which amount or the aggregate of which amounts, as the case may be, shall equal the total dividend allowance for the year for those corporations and all other taxable Canadian corporations with which each such corporation is associated in the year, and the dividend allowance for the year of each of the corporations is the amount so allocated to it.

Dividend allowance in short years

(6) Notwithstanding any other provision of this section,

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

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

Election

191.2(1) For the purposes of determining the tax payable by reason of subparagraphs 191.1(1)(a)(ii) and (iii), a taxable Canadian corporation (other than a financial intermediary corporation or a private holding corporation) may make an election with respect to a class of its taxable preferred shares the terms and conditions of which require an election to be made under this subsection by filing a prescribed form with the Minister

(a) not later than the day on or before which its return of income under Part I is required by section 150 to be filed for the taxation year in which shares of that class are first issued or first become taxable preferred shares, or

(b) within the 90-day period commencing on the day of mailing of a notice of assessment of tax payable under this Part or Part I by the corporation for that year.

Time of election

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

Assessment

(3) Where an election has been filed under subsection (1), the Minister shall, notwithstanding subsections 152(4) and (5), assess or reassess the tax, interest or penalties payable under this Act by any corporation for any relevant taxation year in order to take into account the election.

Agreement respecting liability for tax

191.3(1) Where a corporation (in this section referred to as the "transferor corporation") and a taxable Canadian corporation (in this section referred to as the "transferee corporation") which was related (otherwise than by reason of a right referred to in paragraph 251(5)(b)) to the transferor corporation

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

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

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

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

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

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

Manner of filing agreement

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

(a) it is in prescribed form;

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

(c) it is accompanied by,

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

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

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

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

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

(e) no tax is payable under Part I by the transferor corporation for its taxation year in respect of which the agreement is filed.

Assessment

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

Related Corporations

(4) Where, at any time, a corporation has become related to another corporation and it may reasonably be considered, having regard to all the circumstances, that the main purpose of the corporation becoming related to the other corporation was to transfer, by filing an agreement or an amended agreement under this section, the benefit of a deduction under paragraph 110(1)(k) to a transferee corporation, the amount of the tax specified in such agreement shall, for the purposes of paragraph (1)(c), be deemed to be nil.

Assessment of transferor corporation

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

Payment by transferor corporation

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

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

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

Information Return

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

Provisions applicable to Part

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

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

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

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

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

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

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

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

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

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

-"short-term preferred share" of a corporation at any particular time means a share, other than a grandfathered share, of the capital stock of the corporation issued after December 15, 1987 that at that particular time

(a) is a share where, under the terms and conditions of the share, any agreement relating to the share or any modification of such terms, conditions or agreement, the corporation or a specified person in relation to the corporation is or may, at any time within 5 years from the date of its issue, be required to redeem, acquire or cancel, in whole or in part, the share (unless the requirement to redeem, acquire or cancel the share arises only in the event of the death of the shareholder or by reason only of a right to convert or exchange the share) or to reduce the paid-up capital of the share and for the purposes of this paragraph

(i) an agreement in respect of a share of the capital stock of a corporation shall be read without reference to that part of the agreement under which a person agrees to acquire the share for an amount that does not exceed its fair market value at the time of the acquisition, determined without regard to the agreement, or for an amount determined by reference to the assets or earnings of the corporation where such determination may reasonably be considered to be used to determine an amount that does not exceed the fair market value of the share at the time of the acquisition, determined without regard to the agreement, and

(ii) "shareholder" includes a shareholder of a shareholder, or

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

(i) it is convertible into or exchangeable for

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

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

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

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

and for the purposes of this definition,

(c) where at any particular time after December 15, 1987, otherwise than pursuant to a written arrangement to do so entered into before December 16, 1987, the terms or conditions of a share of the capital stock of a corporation relating to the redemption, acquisition, cancellation, conversion or exchange of the share or to the reduction of the paid-up capital of the share by the corporation or a specified person in relation to the corporation have been modified or established or any agreement in respect of the share relating to any such event or any guarantee agreement (within the meaning assigned by paragraph (h)) in respect of the share, has been changed or entered into by the corporation or a specified person in relation to the corporation, the share shall be deemed after that particular time to have been issued at that particular time,

(d) where at any particular time after December 15, 1987, a particular share of the capital stock of a corporation has been issued or its terms or conditions have been modified or an agreement in respect of the share is modified or entered into, and it may reasonably be considered, having regard to all the circumstances, including the rate of interest on any debt obligation or the dividend provided on any short-term preferred share, that

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

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

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

(e) where at any particular time after December 15, 1987, otherwise than pursuant to a written arrangement to do so entered into before December 16, 1987, the terms or conditions of a share of the capital stock of a corporation are modified or established or any agreement in respect of the share has been changed or entered into, and as a consequence thereof the corporation or a specified person in relation to the corporation may reasonably be expected to redeem, acquire or cancel (otherwise than by reason of the death of the shareholder or by reason only of a right to convert or exchange the share that would not cause the share to be a short-term preferred share by reason of paragraph (b)), in whole or in part, the share, or to reduce its paid-up capital, within 5 years from the particular time, the share shall be deemed to have been issued at that particular time and to be a short-term preferred share of the corporation from the particular time until the time that such reasonable expectation ceases to exist and for the purposes of this paragraph

(i) an agreement in respect of a share of the capital stock of a corporation shall be read without reference to that part of the agreement under which a person agrees to acquire the share for an amount that does not exceed its fair market value at the time of the acquisition, determined without regard to the agreement, or for an amount determined by reference to the assets or earnings of the corporation where such determination may reasonably be considered to be used to determine an amount that does not exceed the fair market value of the share at the time of the acquisition, determined without regard to the agreement, and

(ii) "shareholder" includes a shareholder of a shareholder,

(f) where a share of the capital stock of a corporation was issued after December 15, 1987 and at the time the share was issued the existence of the corporation was, or there was an arrangement under which it could be, limited to a period that was within 5 years from the date of its issue, the share shall be deemed to be a short-term preferred share of the corporation unless the share is a grandfathered share and the arrangement is a written arrangement entered into before December 16, 1987,

(g) where a share of the capital stock of a corporation is acquired at any time after December 15, 1987 by the corporation or a specified person in relation to the corporation and the share is at any particular time after that time acquired by a person with whom the corporation or a specified person in relation to the corporation was dealing at arm's length (otherwise than by reason of a right referred to in paragraph 251(5)(b)), from the corporation or a specified person in relation to the corporation the share shall be deemed after that particular time to have been issued at that particular time,

(h) where at any particular time after December 15, 1987, otherwise than pursuant to a written arrangement to do so entered into before December 16, 1987, as a result of the terms or conditions of a share of the capital stock of a corporation or any agreement entered into by the corporation or a specified person in relation to the corporation, any person (other than the corporation or an individual other than a trust) was obligated, either absolutely or contingently and either immediately or in the future, to effect any undertaking (in this paragraph referred to as a "guarantee agreement") including any guarantee, covenant or agreement to purchase or repurchase the share, and including the lending of funds or the placing of amounts on deposit with, or on behalf of the shareholder or a specified person in relation to the shareholder given

(i) to ensure that any loss that the shareholder or a specified person in relation to the shareholder may realize within 5 years after the date that the share was issued or acquired, by reason of the ownership, holding or disposition of the share or any other property is limited in any respect, and

(ii) as part of a transaction or event or series of transactions or events that included the issuance or acquisition of the share,

the share shall be deemed after that particular time to have been issued at the particular time and to be at and immediately after the particular time a short-term preferred share, and for the purposes of this paragraph, where a guarantee agreement in respect of a share is given at any particular time after December 15, 1987, otherwise than pursuant to a written arrangement to do so entered into before December 16, 1987, the share shall be deemed to have been issued at the particular time and the guarantee agreement shall be deemed to have been given as part of a series of transactions that included the issuance or acquisition of the share,

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

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

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

"grandfathered share"
«action de régime transitoire»

-"grandfathered share" means

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

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

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

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

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

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

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

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

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

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

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

"restricted financial institution"
«institution financière véritable»

"restricted financial institution" means

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

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

- (c) a credit union,
- (d) an insurance corporation,
- (e) a corporation whose principal business is the lending of money to persons with whom the corporation is dealing at arm's length or the purchasing of debt obligations issued by such persons or a combination thereof, or
- (f) a corporation that is controlled by one or more corporations described in any of paragraphs (a) to (e);

"specified financial institution"
«institution financière désignée»

"specified financial institution" means

- (a) a bank to which the Bank Act or the Quebec Savings Banks Act applies,
- (b) a corporation licensed or otherwise authorized under the laws of Canada or a province to carry on in Canada the business of offering to the public its services as trustee,
- (c) a credit union,
- (d) an insurance corporation,
- (e) a corporation whose principal business is the lending of money to persons with whom the corporation is dealing at arm's length or the purchasing of debt obligations issued by such persons or a combination thereof,
- (f) a corporation that is controlled by one or more corporations described in any of paragraphs (a) to (e) and for the purposes of this paragraph, one corporation is controlled by another corporation if more than 50% of its issued share capital (having full voting rights under all circumstances) belongs to the other corporation, to persons with whom the other corporation does not deal at arm's length, or to the other corporation and persons with whom the other corporation does not deal at arm's length, or
- (g) a corporation related to a corporation described in any of paragraphs (a) to (f);

"taxable preferred share"
«action privilégiée imposable»

"taxable preferred share" at any particular time means

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

(b) a share (other than a grandfathered share) of the capital stock of a corporation issued after 8:00 p.m Eastern Daylight Saving Time, June 18, 1987 where, at that particular time by reason of the terms or conditions of the share or any agreement in respect of the share or its issue to which the corporation, or a specified person in relation to the corporation, is a party,

(i) it may reasonably be considered, having regard to all the circumstances, that the amount of the dividends that may be declared or paid on the share (in this definition referred to as the "dividend entitlement") is, by way of a formula or otherwise

(A) fixed,

(B) limited to a maximum, or

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

(ii) it may reasonably be considered, having regard to all the circumstances, that the amount that the shareholder is entitled to receive in respect of the share on the dissolution, liquidation or winding-up of the corporation or on the redemption, acquisition or cancellation of the share or on a reduction of the paid-up capital of the share (unless the requirement to redeem, acquire or cancel the share arises only in the event of the death of the shareholder or by reason only of a conversion or exchange of the share) by the corporation or by a specified person in relation to the corporation (in this definition referred to as the "liquidation entitlement") is, by way of a formula or otherwise

(A) fixed,

(B) limited to a maximum, or

(C) established to be not less than a minimum,

and for the purposes of this subparagraph "shareholder" includes a shareholder of a shareholder

(iii) the share is convertible or exchangeable at any time, unless

(A) it is convertible into or exchangeable for

(I) another share of the corporation or a corporation related to the corporation that, if issued, would not be a taxable preferred share,

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

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

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

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

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

(B) to ensure that the shareholder or a specified person in relation to the shareholder will derive earnings by reason of the ownership, holding or disposition of the share or any other property,

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

but does not include a share that is at the particular time a prescribed share or a share described in paragraph (e) of the definition "term preferred share" in this subsection during the applicable time period referred to in that paragraph and, for the purposes of this definition,

(c) the dividend entitlement of a share of the capital stock of a corporation shall be deemed not to be fixed, limited to a maximum or established to be not less than a minimum where all dividends on the share are determined solely by reference to a multiple or fraction of the dividend entitlement of another share of the capital stock of the corporation or of another corporation that controls the corporation that would not be a taxable preferred share if

(i) this definition were read without reference to paragraph (f),

(ii) the other share were issued after June 18, 1987, and

(iii) the other share were not a grandfathered share, a prescribed share or a share described in paragraph (e) of the definition "term preferred share",

(d) the liquidation entitlement of a share of the capital stock of a corporation shall be deemed not to be fixed, limited to a maximum or established to be not less than a minimum where all the liquidation entitlement is determinable solely by reference to the liquidation entitlement of another share of

the capital stock of the corporation or of another corporation that controls the corporation that would not be a taxable preferred share if

(i) this definition were read without reference to paragraph (f),

(ii) the other share were issued after June 18, 1987, and

(iii) the other share were not a grandfathered share, a prescribed share or a share described in paragraph (e) of the definition "term preferred share",

(e) where at any particular time after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, otherwise than pursuant to a written arrangement to do so entered into before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987, the terms or conditions of a share of the capital stock of a corporation that are relevant to any matter referred to in any of subparagraphs (b)(i) to (iv) are established or modified or any existing agreement in respect of any such matter, to which the corporation or a specified person in relation to the corporation is a party, is changed or an agreement in respect of any such matter to which the corporation or a specified person in relation to the corporation is a party, is entered into, the share shall, for the purpose of determining after the particular time whether it is a taxable preferred share, be deemed to have been issued at that particular time, unless

(i) the share is a share described in paragraph (b) of the definition "grandfathered share", and

(ii) the particular time is before December 16, 1987 and before the time at which the share is first issued,

(f) an agreement in respect of a share of the capital stock of a corporation shall be read without reference to that part of the agreement under which a person agrees to acquire the share for an amount that does not exceed its fair market value at the time of the acquisition, determined without regard to the agreement or for an amount determined by reference to the assets or earnings of the corporation where such determination may reasonably be considered to be used to determine an amount that does not exceed the fair market value of the share at the time of the acquisition, determined without regard to the agreement,

(g) where

(i) it may reasonably be considered that the dividends that may be declared or paid to a shareholder at any time on a share (other than a grandfathered share) of the capital stock of a corporation issued after December 15, 1987 are derived primarily from dividends received on taxable preferred shares of the capital stock of another corporation in which the corporation has a substantial interest (within the meaning of section 191) at that time, and

(ii) it may reasonably be considered that the share was issued or acquired as part of a transaction or event or series of transactions or events one of the main purposes of which was to avoid or limit the application of Part IV.1 or VI.1,

the share shall be deemed at that time to be a taxable preferred share and the shareholder shall be deemed not to have a substantial interest (as determined under section 191) in the corporation at that time,

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

"taxable RFI share"

«action particulière à une institution financière»

"taxable RFI share" at any particular time means a share of the capital stock of a corporation issued before 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 or a grandfathered share of the capital stock of a corporation, where at the particular time under the terms or conditions of the share or any agreement in respect of the share,

(a) it may reasonably be considered, having regard to all the circumstances, that the amount of the dividends that may be declared or paid on the share (in this definition referred to as the "dividend entitlement") is, by way of a formula or otherwise

(i) fixed,

(ii) limited to a maximum, or

(iii) established to be not less than a minimum, or

(b) it may reasonably be considered, having regard to all the circumstances, that the amount that the shareholder is entitled to receive in respect of the share on dissolution, liquidation or winding-up of the corporation (in this definition referred to as the "liquidation entitlement") is, by way of formula or otherwise

(i) fixed,

(ii) limited to a maximum, or

(iii) established to be not less than a minimum,

but does not include a share that is at the particular time a prescribed share, a term preferred share, a share described in paragraph (e) of the definition "term preferred share" in this subsection during the applicable time period referred to in that paragraph or a taxable preferred share and for the purposes of this definition

(c) the dividend entitlement of a share of the capital stock of a corporation shall be deemed not to be fixed, limited to a maximum or established to be not less than a minimum where all dividends on the share are determined solely by reference to a multiple or fraction of the dividend entitlement of another share of the capital stock of the corporation or of another corporation that controls the corporation that would not be a taxable preferred share if

(i) the definition "taxable preferred share" were read without reference to paragraph (f) thereof,

(ii) the other share were issued after June 18, 1987, and

(iii) the other share were not a grandfathered share, a prescribed share or a share described in paragraph (e) of the definition "term preferred share",

(d) the liquidation entitlement of a share of the capital stock of a corporation shall be deemed not to be fixed, limited to a maximum or established to be not less than a minimum where all the liquidation entitlement is determinable solely by reference to the liquidation entitlement of another share the capital stock of the corporation or of another corporation that controls the corporation that would not be a taxable preferred share if

(i) the definition "taxable preferred share" were read without reference to paragraph (f) thereof,

(ii) the other share were issued after June 18, 1987, and

(iii) the other share were not a grandfathered share, a prescribed share or a share described in paragraph (e) of the definition "term preferred share", and

(e) where

(i) it may reasonably be considered that the dividends that may be declared or paid to a shareholder at any time on a share of the capital stock of a corporation issued after December 15, 1987 are derived primarily from dividends received on taxable RFI shares of the capital stock of another corporation, and

(ii) it may reasonably be considered that the share was issued or acquired as part of a transaction or event or series of transactions or events one of the main purposes of which was to avoid or limit the application of Part IV.1,

the share shall be deemed at that time to be a taxable RFI share and the shareholder shall be deemed not to have a substantial interest (as determined under section 191) in the corporation at that time;" -

(3) The definition "amount" in subsection 248(1) of the said Act is repealed and the following substituted therefor:

"amount"

«montant ou somme»

""amount" means money, rights or things expressed in terms of the amount of money or the value in terms of money of the right or thing, except that

(a) notwithstanding paragraph (b), in any case where subsection 112(2.1), (2.2) or (2.4), or section 187.2 or 187.3 or subsection 258(3) or (5) applies to a stock dividend, the "amount" of the stock dividend is the greater of

(i) the amount by which the paid-up capital of the corporation that paid the dividend is increased by reason of the payment of the dividend, and

(ii) the fair market value of the share or shares paid as a stock dividend at the time of payment,

(b) in any case where section 191.1 applies to a stock dividend, the "amount" of the stock dividend for the purposes of Part VI.1 is the greater of

(i) the amount by which the paid-up capital of the corporation that paid the dividend is increased by reason of the payment of the dividend, and

(ii) the fair market value of the share or shares paid as a stock dividend at the time of payment,

and for any other purpose the amount referred to in subparagraph (i), and

(c) in any other case, the "amount" of any stock dividend is the amount by which the paid-up capital of the corporation that paid the dividend is increased by reason of the payment of the dividend;"

(4) Subparagraphs (e)(iv) and (v) of the definition "income bond" in subsection 248(1) of the said Act are repealed and the following substituted therefor:

"(iv) at any particular time after October 23, 1979, a bond or debenture issued before November 17, 1978 or a bond or debenture issued pursuant to an established agreement (other than a bond or debenture issued to a corporation described in any of paragraphs (a) to (f) of the definition "specified financial institution" in this subsection) is acquired (otherwise than pursuant to an agreement in writing made before October 24, 1979) from a person (other than a corporation described in any of paragraphs (a) to (f) of the definition "specified financial institution" in this subsection) by a specified financial institution or by a partnership or trust of which a specified financial institution or a person related thereto is a member or beneficiary, or

(v) at any particular time after November 12, 1981, a bond or debenture (other than a bond or debenture referred to in paragraph (c)) is acquired by a specified financial institution or by a partnership or trust of which a specified financial institution or a person related thereto is a member or beneficiary from a corporation described in any of paragraphs (a) to (f) of the definition "specified financial institution" in this subsection and the acquisition is subject to or conditional upon a guarantee agreement (within the meaning that would be assigned by subsection 112(2.2) if the

reference therein to a "share" were read as a reference to an "income bond" or "income debenture") that was entered into after November 12, 1981,"

(5) Subparagraph (a)(iv) of the definition "term preferred share" in subsection 248(1) of the said Act is repealed and the following substituted therefor:

- "(iv) the share is convertible or exchangeable unless

(A) it is convertible into or exchangeable for

(I) another share of the issuing corporation or a corporation related to the issuing corporation that, if issued, would not be a term preferred share,

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

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

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

(6) Paragraph (b) of the definition "term preferred share" is repealed and the following substituted therefor:

"(b) the owner thereof acquired the share after October 23, 1979 and is

(i) a corporation described in any of paragraphs (a) to (e) of the definition "specified financial institution" in this subsection,

(ii) a corporation that is controlled directly or indirectly by one or more corporations described in subparagraph (i),

(iii) a corporation that acquired the share after December 11, 1979 and is related to a corporation referred to in subparagraph (i) or (ii), or

(iv) a partnership or trust of which a corporation referred to in subparagraph (i) or (ii) or a person related thereto is a member or a beneficiary,

that (either alone or together with any of such corporations, partnerships or trusts) controls directly or indirectly or has an absolute or contingent right to control directly or indirectly or to acquire direct or indirect control of the issuing corporation,"

(7) Subparagraph (e)(iii) of the definition "term preferred share" in subsection 248(1) of the said Act is repealed and the following substituted therefor:

"(iii) at a time when, by reason of financial difficulty, the issuing corporation or another corporation resident in Canada with which it does not deal at arm's length was in default, or could reasonably be expected to default, on a debt obligation held by a person with whom the issuing corporation or the other corporation was dealing at arm's length and the share was issued either wholly or in substantial part and either directly or indirectly in exchange or substitution for that obligation or a part thereof,"

(8) The definition "term preferred share" in subsection 248(1) of the said Act is further amended by striking out the word "or" at the end of paragraph (e) thereof, by adding the word "or" at the end of paragraph (f) thereof and by adding thereto, immediately after paragraph (f) thereof, the following paragraph:

-(f.1) that is a taxable preferred share (other than a share deemed by paragraph (e) of the definition "taxable preferred share" or paragraph (i.2) to have been issued after December 15, 1987) held by a specified financial institution that acquired the share

(i) before December 16, 1987, or

(ii) before 1989 pursuant to an agreement in writing entered into before December 16, 1987," -

(9) Subparagraphs (h)(iv), (v) and (vi) of the definition "term preferred share" in subsection 248(1) are repealed and the following substituted therefor:

"(iv) a share issued before November 17, 1978 or a share issued pursuant to an established agreement (other than a share issued to a corporation described in any of paragraphs (a) to (f) of the definition "specified financial institution" in this subsection), is, at any particular time after October 23, 1979 and before November 13, 1981 acquired (otherwise than pursuant to an agreement in writing made before October 24, 1979) from a person (other than a corporation described in any of paragraphs (a) to (f) of the definition "specified financial institution" in this subsection) by a specified financial institution or by a partnership or trust of which a specified financial institution or a person related thereto is a member or a beneficiary,

(v) at any particular time after November 12, 1981

(A) in respect of

(I) a share (other than a share referred to in paragraph (e) or a share listed on November 13, 1981 on a prescribed stock exchange in Canada) issued after November 16, 1978 and before November 13, 1981, or

(II) a share issued after November 12, 1981 and before 1983 pursuant to an agreement in writing to do so made before November 13, 1981 (in this definition referred to as a "specified agreement")

the owner thereof could require either alone or together with one or more taxpayers, the redemption, acquisition, cancellation, conversion or reduction of the paid-up capital of the share otherwise than by reason of a failure or default under the terms or conditions of the share or any agreement that related to, and was entered into at the time of, the issuance of the share, or

(B) the redemption date of

(I) a share issued after November 16, 1978 and before November 13, 1981 or

(II) a share issued pursuant to a specified agreement

was extended or the terms or conditions relating to its redemption, acquisition, cancellation, conversion or reduction of its paid-up capital were changed, or

(vi) a share (other than a share referred to in paragraph (e)) issued before November 13, 1981 or a share issued pursuant to a specified agreement is, at any particular time after November 12, 1981, acquired (otherwise than pursuant to an agreement in writing made before October 24, 1979 or otherwise than pursuant to a specified agreement) from a partnership or person (other than an acquisition from a corporation described in any of paragraphs (a) to (f) of the definition "specified financial institution" in this subsection where such acquisition is neither subject to or conditional upon a guarantee agreement, within the meaning assigned by subsection 112(2.2), entered into after November 12, 1981) by a specified financial institution or by a partnership or trust of which a specified financial institution or a person related thereto is a member or a beneficiary,

(10) The definition "term preferred share" in subsection 248(1) of the Act is further amended by striking out the word "and" at the end of paragraph (i) thereof and by adding thereto, immediately after paragraph (i) thereof, the following paragraphs:

(i.1) where

(i) it may reasonably be considered that the dividends that may be declared or paid at any time on a share of the capital stock of a corporation issued after December 15, 1987 are derived primarily from dividends received on term preferred shares of the capital stock of another corporation, and

(ii) it may reasonably be considered that the share was issued or acquired as part of a transaction or event or series of transactions or events one of the main purposes of which was to avoid or limit the application of subsection 112(2.1) or 138(6),

the share shall be deemed at that time to be a term preferred share acquired in the ordinary course of business,

(i.2) where at any particular time after December 15, 1987, otherwise than pursuant to a written arrangement to do so entered into before December 16, 1987, the terms or conditions of a taxable preferred share of the capital stock of a corporation relating to any matter referred to in subparagraphs (a)(i) to (iv) have been modified or established, or any agreement in respect of the share relating to any such matter has been changed or entered into by the corporation or a specified person (within the meaning assigned by paragraph (h) of the definition "taxable prepared share" in this subsection)

in relation to the corporation , the share shall be deemed after that particular time to have been issued at that particular time, and," -

(11) All that portion of the definition "term preferred share" in subsection 248(1) of the said Act following paragraph (j) thereof is repealed.

(12) Subsection 248(6) of the said Act is repealed and the following substituted therefor:

Series of Shares

"(6) In its application in relation to a corporation that has issued shares of a class of its capital stock in one or more series, a reference in this Act to the "class" shall be read, with such modifications as the circumstances require, as a reference to a "series of the class."

(13) Section 248 of the said Act is further amended by adding thereto the following subsections:

Interests in trusts and partnerships

- "(12) Where after November 12, 1981 a person has an interest in a trust or partnership, whether directly or indirectly through an interest in any other trust or partnership or in any manner whatever, the person shall, for the purposes of the definitions "income bond", "income debenture" and "term preferred share" in subsection (1), paragraph (h) of the definition "taxable preferred share" in subsection (1), subsections 84(4.2) to (4.4) and 112(2.6) and section 258 be deemed to be a beneficiary of the trust or a member of the partnership, as the case may be.

Related Corporations

(13) For the purposes of paragraph (g) of the definition "specified financial institution" in subsection (1), where, in the case of two or more corporations, it may reasonably be considered, having regard to all the circumstances, that one of the main reasons for the separate existence of those corporations in a taxation year is to limit or avoid the application of subsection 112(2.1) or (2.2), the two or more corporations shall be deemed to be related to each other." -

(14) Subsection (1) is applicable with respect to shares issued after December 15, 1987 and shares deemed by the said Act to have been issued after that time.

(15) The definition "restricted financial institution" in subsection 248(1), as enacted by subsection (2), is applicable June 18, 1987.

(16) The definitions "grandfathered share" and "taxable preferred share" in subsection 248(1) of the said Act, as enacted by subsection (2), and subsections (7), (11) and (12) are applicable with respect to shares issued after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987 and shares deemed by the said Act to have been issued after that time.

(17) The definitions "specified financial institution" and "taxable RFI share" in subsection 248(1) of the said Act, as enacted by subsection (2), and subsections (4), (5), (6), (8), (9) and (13) are applicable June 18, 1987.

(18) Subsection (3) is applicable with respect to dividends paid after June 18, 1987.

(19) Subsection (10) is applicable with respect to shares issued after December 15, 1987 and shares deemed to have been issued after that time by paragraph (i.2) of the definition "term preferred share" in subsection 248(1) of the said Act, as enacted by subsection (10).

18.(1) Subsection 258(1) of the said Act is repealed.

(2) Subsection 258(3) of the said Act is repealed and the following substituted therefor:

Deemed interest on preferred shares

"(3) For the purposes of paragraphs 12(1)(c) and (k) and sections 113 and 126 and subject to subsection (4), a dividend received in a taxation year on

(a) a term preferred share by a specified financial institution from a corporation not resident in Canada, or

-(b) any other share by any corporation from a corporation not resident in Canada, if the dividend would have been a dividend in respect of which no deduction could have been made under subsection 112(1) or (2) or 138(6) (by reason of subsection 112(2.2), as it read on June 17, 1987) if the payer corporation were a taxable Canadian corporation at the time the dividend was paid -

shall be deemed to be interest received in the year and not a dividend received on a share of the capital stock of a corporation."

(3) Section 258 is further amended by adding thereto the following subsection:

Deemed interest on certain shares

- "(5) For the purposes of paragraphs 12(1)(c) and (k) and sections 113 and 126, a dividend received after June 18, 1987 and in a taxation year from a corporation not resident in Canada, other than a corporation in which the recipient had or would have, if the corporation were a taxable Canadian corporation, a substantial interest (within the meaning assigned by section 191), on a share, if the dividend would have been a dividend in respect of which no deduction could have been made under subsection 112(1) or (2) or 138(6) (by reason of subsection 112(2.2) or (2.4)) if the payer corporation were a taxable Canadian corporation at the time the dividend was paid, shall be deemed to be interest received in the year and not a dividend received on a share of the capital stock of the payer corporation." -

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

(5) Subsection (2) is applicable with respect to dividends received or deemed by the said Act to be received on shares acquired after 8:00 p.m. Eastern Daylight Saving Time, June 18, 1987.

(6) Subsection (3) is applicable after June 18, 1987.

Draft Regulations

Preferred Shares

DRAFT REGULATIONS
PREFERRED SHARES

1. Section 3200 of the Income Tax Regulations is revoked and the following substituted therefor:

"3200. The following stock exchanges in Canada are hereby prescribed for the purposes of sections 47.1, 70 and 89, subsection 112(2.2), sections 146, 146.2, 146.3, 149.1, 187.3 and 204, subsection 206(2) and section 206.1 of the Act and the definitions "grandfathered share" and "term preferred share" in subsection 248(1) of the Act:

- (a) Alberta Stock Exchange;
- (b) Montreal Stock Exchange;
- (c) Toronto Stock Exchange;
- (d) Vancouver Stock Exchange;
- (e) Winnipeg Stock Exchange."

2.(1) Subsection 5301(1) of the said Regulations is revoked and the following substituted therefor:

"5301.(1) Subject to subsections (6) and (8), for the purposes of subsection 157(4) and 161(9) of the Act, the "first instalment base" of a corporation for a particular taxation year means the product obtained when the aggregate of

- (a) the tax payable by the corporation under Part I of the Act for its taxation year immediately preceding the particular year computed without reference to sections 123.1, 127.2 and 127.3 thereof and before taking into consideration any amount referred to in any of subparagraphs 161(7)(a)(i) to (vii) thereof that was excluded or deducted, as the case may be, and
- (b) the tax payable by the corporation under Part VI.1 of the Act for its taxation year immediately preceding the particular year,

is multiplied by the ratio that 365 is of the number of days in that preceding year."

(2) Subparagraph 5301(4)(a)(i) of the said Regulations is revoked and the following substituted therefor:

"(i) its "first instalment base" for the particular year means the aggregate of all amounts, each of which is equal to the product obtained when the aggregate of

(A) the tax payable under Part I of the Act, computed without reference to sections 123.1, 127.2 and 127.3 thereof and before taking into consideration any amount referred to in any of subparagraphs 161(7)(a)(i) to (vii) thereof that was excluded or deducted, as the case may be, and

(B) the tax payable under Part VI.1 of the Act

by a predecessor corporation (within the meaning assigned by section 87 of the Act) for its last taxation year is multiplied by the ratio that 365 is of the number of days in that year, and"

3. Subsection 6201(2) of the said Regulations is revoked and the following substituted therefor:

"(2) For the purposes of paragraph (f) of the definition "term preferred share" in subsection 248(1) of the Act, a particular share acquired after June 28, 1982 and of a class of the capital stock of a corporation that is listed on a stock exchange referred to in section 3200 is a prescribed share at any time with respect to another corporation that receives a dividend at that time in respect of the share unless

(a) dividends are received at that time by the other corporation or by the other corporation and persons with whom the other corporation does not deal at arm's length in respect of more than 10 per cent of the issued and outstanding shares of the class,

(b) the other corporation is a restricted financial institution, dividends are received at that time by the other corporation or by the other corporation and restricted financial institutions with whom the other corporation does not deal at arm's length in respect of more than 5% of the issued and outstanding shares of that class and a dividend is received at that time by the other corporation or a restricted financial institution with whom the other corporation does not deal at arm's length in respect of a share of that class acquired after December 15, 1987 by the other corporation or a restricted financial institution with whom the other corporation does not deal at arm's length and the particular share is not a taxable preferred share, or

(c) the other corporation is a restricted financial institution and the particular share

(i) is not a taxable preferred share,

(ii) was acquired after December 15, 1987 and before that time, and

(iii) was deemed under paragraph (h) of the definition "term preferred share" in subsection 248(1) of the Act to have been issued after December 15, 1987 and before that time."

4. Subsection 6201(4) of the said Regulations is revoked and the following substituted therefor:

"(4) For the purposes of the definition "taxable RFI share" in subsection 248(1) of the Act, a share of a class of the capital stock of a corporation that is listed on a stock exchange referred to in section 3200 is a prescribed share at any time with respect to another corporation that is a restricted financial institution that receives a dividend at that time in respect of the share unless dividends are received at that time by the other corporation or by the other corporation and restricted financial institutions with whom the other corporation does not deal at arm's length in respect of more than

(a) 10% of the issued and outstanding shares of that class where no dividend is received at that time by the other corporation or a restricted financial institution with whom the other corporation does not deal at arm's length in respect of a share of that class acquired after December 15, 1987 by the other corporation or a restricted financial institution with whom the other corporation does not deal at arm's length, or

(b) 5% of the issued and outstanding shares of that class where a dividend is received at that time by the other corporation or a restricted financial institution with whom the other corporation does not deal at arm's length in respect of a share of that class acquired after December 15, 1987 by the other corporation or a restricted financial institution with whom the other corporation does not deal at arm's length.

(5) For the purpose of determining under subsection (2) or (4) the year in which a share of a class of the capital stock of a corporation was acquired by any taxpayer, shares of that class acquired by the taxpayer at any time before a disposition by him of shares of that class shall be deemed to have been disposed of before shares of that class acquired by him before that time.

(6) For the purposes of subsections (2), (4) and (5) and this subsection,

(a) where a taxpayer is a beneficiary of a trust and an amount in respect of the beneficiary has been designated by the trust in a taxation year pursuant to subsection 104(19) of the Act, the taxpayer shall be deemed to have received the amount so designated at the time it was received by the trust; and

(b) where a taxpayer is a member of a partnership and a dividend has been received by the partnership, the taxpayer's share of the dividend shall be deemed to have been received by the taxpayer at the time the dividend was received by the partnership."

(7) For the purposes of subsections (2) and (4),

(a) a share of the capital stock of a corporation acquired by a person after December 15, 1987 pursuant to an agreement in writing entered into before December 16, 1987 shall be deemed to have been acquired by that person before December 16, 1987;

(b) a share of the capital stock of a corporation acquired by a person after December 15, 1987 and before July, 1988 as part of a distribution to the public made in accordance with the terms of a prospectus, preliminary prospectus, registration statement, offering memorandum or notice filed before December 15, 1987 with a public authority pursuant to and in accordance with the securities legislation of the jurisdiction in which the shares are distributed shall be deemed to have been acquired by that person before December 16, 1987;

(c) where a share that was owned by a particular restricted financial institution on December 15, 1987 has, by one or more transactions between related restricted financial institutions, been transferred to another restricted financial institution, the share shall be deemed to have been acquired by the other restricted financial institution before that date and after June 28, 1982 unless at any particular time after December 15, 1987 and before the share was transferred to the other

restricted financial institution the share was owned by a shareholder who, at that particular time, was a person other than a restricted financial institution related to the other restricted financial institution; and

(d) where, at any particular time, there has been an amalgamation within the meaning assigned by section 87, and

(i) each of the predecessor corporations was a restricted financial institution throughout the period from December 16, 1987 to the particular time and the predecessor corporations were related to each other throughout that period, or

(ii) each of the predecessor corporations and the new corporation is a corporation described in any of paragraphs (a) to (d) of the definition "restricted financial institution" in subsection 248(1) of the Act,

a taxable RFI share acquired by the new corporation from a predecessor corporation on the amalgamation shall be deemed to have been acquired by the new corporation at the time it was acquired by the predecessor corporation."

5. All that portion of section 6700 of the said Regulations preceding paragraph (a) thereof is revoked and the following substituted therefor:

"6700. For the purposes of paragraph 40(2)(i), clause 53(2)(k)(i)(C), paragraph 125(7)(b), sections 186.1, 186.2 and 187.1 and subsection 191(1) of the Act and in this Part and Part LI, "prescribed venture capital corporation" means at any particular time"

6. Section 6701 of the said Regulations is revoked and the following substituted therefor:

"6701. For the purposes of paragraph 40(2)(i), clause 53(2)(k)(i)(C), the definition "approved share" in subsection 127.4(1), sections 186.1 and 187.1 and subsection 191(1) of the Act, the corporation established by an Act to Establish the Fonds de Solidarité des Travailleurs du Québec (F.T.Q.), Statutes of Quebec 1983, chapter 58, as amended, is a prescribed labour-sponsored venture capital corporation."

7. Section 1 is applicable after October 31, 1985.

8. Section 2 is applicable to the 1988 and subsequent taxation years.

9. Sections 3 to 6 are applicable after June 18, 1987.

**Explanatory Notes to
Draft Legislation Respecting
Preferred Share Financing**

Clause 1
Dividends received
ITA
82(2)

Section 82 of the Act deals with the tax treatment of dividends received from corporations resident in Canada. Subsection 82(2) provides that dividends received by one taxpayer but included under certain attribution rules in computing the income of another taxpayer are treated as having been received by the other taxpayer for the purposes of section 82 (relating to the inclusion of dividends into income), section 112 (relating to the inter-corporate dividend deduction) and section 121 (relating to the dividend tax credit). The amendment to subsection 82(2) makes this rule applicable for all purposes of the Act. It will thus apply for the purposes of section 113 (relating to dividends from foreign affiliates) and section 258 (the special rules relating to income bonds and debentures and certain dividends from corporations not resident in Canada). The amendment will also have the effect of extending the application of subsection 82(2) for the purposes of the Part IV tax and the special tax imposed under new Part IV.1 on certain dividends received on taxable preferred shares and taxable RFI shares.

The amendment to subsection 82(2) is effective for dividends received after June 18, 1987.

Clause 2
Deemed dividends
ITA
84(4.2) to (4.5)

Subsections 84(1) to (4.1) of the Act provide that share redemptions and certain other transactions relating to shares of the capital stock of a corporation result in a deemed dividend. New subsections 84(4.2), (4.3), (4.4) and (4.5) extend that treatment to certain transactions involving term preferred shares, taxable preferred shares, taxable RFI shares and guaranteed shares to which subsection 112(2.2) applies.

New subsection 84(4.2) replaces existing subsection 258(1) which is consequently repealed. Subsection 258(1) is applicable with respect to an amount received on the reduction of the paid-up capital of a term preferred share and, therefore, parallels the tax treatment under subsection 84(4.1) of an amount received on the reduction of the paid-up capital of a share of a public corporation. For that reason, section 84 is the more logical location in the Act for this provision.

New subsection 84(4.3) of the Act parallels the tax treatment under new subsection 84(4.2) but applies with respect to taxable preferred shares. Generally, where the paid-up capital of a share of the capital stock of a corporation that is not a public corporation is reduced otherwise than by transactions that result in a disposition of the share, a dividend is deemed to have been received by the shareholder only to the extent that the amount received exceeds the reduction of the paid-up capital of that share. This effectively allows a tax-free distribution to shareholders of an amount up to the paid-up capital of their shares. In the context of the new Part IV.1 and VI.1 taxes, such distributions would permit a shareholder to obtain a return of capital in lieu of dividends on a taxable preferred share in order to defer taxation until the share is sold. New subsection 84(4.3) provides that the total amount received by a shareholder on a reduction of the paid-up capital of any such share (rather than only that part of the amount that exceeds its paid-up capital) shall be treated as a dividend paid and received on the share.

New subsection 84(4.4) of the Act has a similar effect but is applicable with respect to taxable RFI shares. This subsection applies where the paid-up capital of such a share of the capital stock of a corporation that is not a public corporation is reduced otherwise than by a transaction that results in a disposition of the share and where, at that time, the share is owned by a restricted financial institution (defined in subsection 248(1)) or by a partnership or trust of which such a restricted financial institution is a member or beneficiary. Where these conditions are met, the total amount received by the shareholder on the reduction of the paid-up capital of any such share (rather than only that part of the amount that exceeds its paid-up capital) shall be treated as a dividend received on the share.

New subsection 84(4.5) of the Act has a similar effect but is applicable to guaranteed shares to which subsection 112(2.2) would apply to deny a deduction under subsection 112(1), (2) or 138(6) of a dividend received on the share. This subsection applies where the paid-up capital of such a share of the capital stock of a corporation that is not a public corporation is reduced otherwise than by transaction that results in a disposition of the share and the share is held by a corporation. In these circumstances, the total amount received by the shareholder on the reduction of the paid-up capital of any such share (rather than only that part of the amount that exceeds its paid-up capital) shall be treated as a dividend received on the share.

New subsections 84(4.2) to (4.5) are applicable with respect to reductions of paid-up capital after 1987.

Clause 3
Amalgamations
ITA
87

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

Subclause 3(1)
ITA
87(2)(rr) and (ss)

New paragraphs 87(2)(rr) and (ss) of the Act are consequential on the introduction of subsection 112(2.9) and the special taxes in Parts IV.1 and VI.1.

New Part VI.1 provides for a special tax on certain dividends paid on taxable preferred shares in excess of an annual \$500,000 threshold amount -- referred to in the Act as a dividend allowance. This allowance is determined for any taxation year by reference to dividends paid in the preceding calendar year. The reference in new paragraph 87(2)(rr) to new subsections 191.1(2) and (4) ensures that in computing the dividend allowance of an amalgamated corporation the dividends paid by its predecessor corporations in the previous calendar year are taken into account.

Subsection 112(2.9) prevents corporations from becoming related for the purpose of avoiding the denial of the deduction provided for in subsection 112(2.4) for dividends received from corporations other than related corporations. The reference in new paragraph 87(2)(rr) to subsection 112(2.9) ensures that, for the purpose of that subsection, an amalgamated corporation will be considered not to be related to another corporation where a predecessor corporation became related to that other corporation for the purpose of avoiding the application of subsection 112(2.4).

New subsection 191(4) exempts from the application of the new Parts IV.1 and VI.1 certain deemed dividends arising on the redemption, acquisition or cancellation of a share by a corporation in the course of a corporate reorganization. For this exception to apply, paragraph 191(4)(c) requires that the share must have been issued for consideration that does not include a taxable preferred share of the corporation. The reference in new paragraph 87(2)(rr) to subsection 191(4) ensures that the condition in paragraph 191(4)(c) will not be satisfied where a share of an amalgamated corporation is issued in consideration for a share of a predecessor corporation that was a taxable preferred share.

New section 191.3 allows a special election to be made for the purposes of the new Part VI.1 tax to permit a corporation to assign its liability for the tax on dividends paid by the corporation on taxable preferred shares to a corporation related to it. The reference to this section in paragraph 87(2)(ss) ensures that any such election remains valid where either corporation is amalgamated. For this purpose the amalgamated corporation is treated as being the same corporation as its predecessor corporations.

New paragraphs 87(2)(rr) and (ss) apply with respect to amalgamations after June 18, 1987.

Subclause 3(2)

ITA

87(4.2) and (4.3)

New subsection 87(4.2) of the Act is consequential on the introduction of new rules relating to the tax treatment of preferred shares. The status of certain preferred shares depends on their date of issue or acquisition. The purpose of this new subsection is to treat preferred shares issued on an amalgamation in exchange for substantially similar shares issued by a predecessor as having been issued when they were issued by the predecessor and under the same circumstances. This subsection treats these shares as having been acquired by the shareholder at the same time he acquired the exchanged shares. Thus, for example, where a share of a predecessor would have been a taxable preferred share but for the fact that it was issued before June 18, 1987, a new share issued on an amalgamation in exchange for that share will not be a taxable preferred share where it has substantially similar terms and conditions.

This subsection also applies to preserve any special election provided for in section 191.2 that had been made by a predecessor corporation before an amalgamation where the newly amalgamated corporation issues shares the terms and conditions of which are substantially the same as those of an elected class of shares of the predecessor.

This subsection applies with respect to amalgamations after November 27, 1986.

Under paragraph (d) of the definition "grandfathered share" a share issued after 8:00 p.m. EDT, June 18, 1987 upon the exercise of a right issued before that time and listed on a prescribed stock exchange where the right to the exchange and the terms of the share were established before 8:00 p.m. EDT, June 18, 1987 will be considered to be a grandfathered share. In circumstances where there has been an amalgamation or merger of two or more corporations, new subsection 87(4.3) will deem a new right to acquire a share of a new corporation acquired in exchange for a right described in paragraph (d)

of the definition "grandfathered share" to acquire a share of a predecessor corporation to be the same right provided that the terms and conditions of both rights and both shares are the same or substantially the same.

This subsection applies with respect to amalgamations occurring after June 18, 1987.

Subclauses 3(3) and (4)

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

Clause 4
Windings-Up
ITA
88

Section 88 of the Act sets out the rules that apply on the winding-up of a corporation.

Subclause 4(1)
ITA
88(1)(e.2)

Subsection 88(1) of the Act sets out rules that apply on the winding-up of a subsidiary into a parent corporation that owns at least 90 per cent of its shares. Under paragraph 88(1)(e.2) many of the detailed rules to be applied on a winding-up of a subsidiary into its parent are adopted by way of cross-reference to the corresponding provisions in section 87 relating to amalgamations. The amendment to paragraph 88(1)(e.2) is consequential on the new rules relating to the tax treatment of preferred shares. This amendment treats the parent corporation as the same corporation as the subsidiary corporation for the purposes of the provisions mentioned in new paragraph 87(2)(rr) which are discussed above. This amendment is applicable to windings-up ending after June 18, 1987.

Subclause 4(2)
ITA
88(1.1)(e)

Existing paragraph 88(1.1)(e) of the Act provides that where control of a parent or subsidiary corporation has been acquired special rules apply to restrict the ability of the parent following the winding-up of the subsidiary to deduct any non-capital losses or farm losses incurred by the subsidiary before the acquisition of control. In these circumstances the only losses of the subsidiary that will be available to the parent

corporation will be the subsidiary's farm losses or non-capital losses that may reasonably be regarded as its losses from carrying on a business.

As discussed in the commentary on new paragraph 110(1)(k), the deduction provided by this paragraph effectively allows a corporation to offset the new Part VI.1 tax against its Part I tax liability. Under the amendment proposed to clause 111(8)(b)(i)(A), the unused portion of the deduction allowed by paragraph 110(1)(k) in a taxation year becomes part of the corporation's non-capital loss for the year. As such, it may then be carried over for deduction in the three preceding and seven subsequent taxation years. The amendment ensures that where there has been an acquisition of control of the parent or subsidiary, the parent will be allowed in a subsequent taxation year to deduct that portion of the subsidiary's non-capital loss that may reasonably be regarded as being in respect of a deduction under new paragraph 110(1)(k) but only if the subsidiary carried on a business in the year in which the deduction arose and only to the extent of the parent's income from that business or from a similar business throughout the subsequent year. This amendment, which parallels similar amendments to subsection 111(5), is applicable with respect to non-capital losses and farm losses for the 1988 and subsequent taxation years.

Subclauses 4(3) and (4)

These set out the effective dates for the amendments to section 88 of the Act.

Clause 5

Dividends Received by Beneficiaries

ITA

104(19)

Subsection 104(19) of the Act permits a trust to designate dividends received by it in a taxation year on shares of a taxable Canadian corporation to be taxable dividends received by a beneficiary of the trust in the year from the corporation. New subsection 104(19) is introduced for the 1988 and subsequent taxation years to clarify that any dividend so designated by a trust shall be considered to have been received by the beneficiary on the share of the capital stock of the corporation on which the dividend was received by the trust. This measure thus ensures that where a dividend is received on a taxable preferred share or a taxable RFI share a beneficiary of a trust will be equally subject to tax under new Part IV.1 whether the dividend is received directly by the beneficiary or received by the trust and allocated to the beneficiary.

Clause 6
ITA
110(1)(k)

New paragraph 110(1)(k) of the Act provides a deduction in computing a corporation's taxable income equal to 2 1/2 times any tax payable by it for the year under Part VI.1 on dividends paid on taxable preferred shares. The purpose of this deduction is to permit an approximate offset of any Part VI.1 tax payable for a year against the corporate income tax payable either for the year or for another year through the non-capital loss carry-back and carry-forward mechanism.

This amendment is applicable to the 1988 and subsequent taxation years. In the case of taxation years ending before July 1988, however, the deduction allowed to a corporation under paragraph 110(1)(k) will be equal to 2 times, rather than 2 1/2 times, the tax payable for the year under Part VI.1. This adjustment takes into account the higher rate of corporate tax applicable to taxation years ending before July 1, 1988.

Clause 7
Losses
ITA
111

Section 111 of the Act sets out the rules relating to the carryover of losses.

Subclauses 7(1) and (2)
ITA
111(5)(a) and (b)

The amendments to paragraphs 111(5)(a) and (b) of the Act are consequential on the inclusion in non-capital losses of amounts deductible under new paragraph 110(1)(k). Without these changes and the change to paragraph 88(1.1)(e) which is discussed above, the amounts included in a corporation's non-capital loss resulting from a deduction under new paragraph 110(1)(k) would cease to qualify for carry-forward or carry-back after an acquisition of control of the corporation. The amendment to paragraph 111(5)(a) will ensure that, where there has been an acquisition of its control, a corporation will be allowed in a subsequent taxation year to deduct that portion of its non-capital loss or farm loss that may reasonably be regarded as being in respect of a deduction under new paragraph 110(1)(k), but only if the corporation carried on a business in the year in which the deduction arose and only to the extent of its income from that business or from a similar business throughout the subsequent year. The amendment to paragraph 111(5)(b) provides a similar rule with regard to the carry-back of a non-capital loss or farm loss realized after an acquisition of control. The

amendments to these paragraphs are applicable with respect to non-capital losses and farm losses for the 1988 and subsequent taxation years.

Subclause 7(3)
ITA
111(8)(b)(i)(A)

The amendment to clause 111(8)(b)(i)(A) of the Act ensures that the unused part of the amount deductible under paragraph 110(1)(k) by a corporation (2 1/2 times its Part VI.1 taxes payable) will be included in the computation of its non-capital loss that is available for carryover to the preceding three and subsequent seven taxation years. The amount by which the non-capital loss will be increased is the unused portion of the paragraph 110(1)(k) deduction -- that is, the portion that did not reduce the corporation's taxable income for the year in which it was deductible. This amendment is applicable to the 1988 and subsequent taxation years subject to special rules discussed below (see commentary under subclause 6(5)).

Subclause 7(4)

This sets out the effective date for the amendments to paragraphs 111(5)(a) and (b) of the Act.

Subclause 7(5)

Subclause (5) sets out the effective date for the amendment to clause 111(8)(b)(i)(A) of the Act. This amendment is generally applicable to the 1988 and subsequent taxation years. However, when a corporation's non-capital loss for a taxation year ending after July 1, 1988 is carried back to a taxation year ending before that date, paragraph (a) provides that this non-capital loss shall be reduced in order to account for the fact that the deduction allowed to a corporation under paragraph 110(1)(k) for such a taxation year ending before that date is equal to 2, rather than 2 1/2, times its tax payable under Part VI.1. This reduction is one-fifth of the lesser of the deduction under paragraph 110(1)(k) and the non-capital loss otherwise computed. However, paragraph (c) provides that for the purposes of determining under subsection 111(3) of the Act which part of that non-capital loss has been so deducted in a taxation year ending before July 1, 1988, the amount of the non-capital loss that has been deducted in that year shall be computed without taking into account the reduction made under paragraph (a).

In the same way, when a corporation's non-capital loss for a taxation year ending before July 1, 1988 is carried forward to a taxation year ending after that date, a corresponding increase in the part of that

non-capital loss that is attributable to a deduction under paragraph 110(1)(k) of the Act is appropriate. This is provided for in paragraph (b).

Clause 8
Taxable Dividends
ITA
112

Section 112 of the Act is one of the principal provisions dealing with the treatment of dividends received by a corporation resident in Canada from another corporation. Subsection 112(1) permits a corporation to deduct taxable dividends in computing its taxable income.

Subclause 8(1)
ITA
112(2.1)

Subsection 112(2.1) of the Act prevents a specified financial institution from deducting taxable dividends received on most term preferred shares in computing its taxable income. This subsection is amended as a consequence of the introduction of a definition of "specified financial institution" in subsection 248(1). It is also amended to provide that a dividend received by a restricted financial institution on a share of a mutual fund corporation or an investment corporation after that corporation has elected under new subsection 131(10) of the Act not to be treated as a restricted financial institution will be considered to have been paid on a term preferred share acquired in the ordinary course of business. This amendment is applicable with respect to dividends received after 8:00 p.m. EDT, June 18, 1987.

Subclause 8(2)
ITA
112(2.2)

Subsection 112(2.2) of the Act denies the intercorporate dividend deduction for dividends on certain shares that are guaranteed by a specified financial institution. This subsection, as amended, generally applies to dividends received on shares issued, or deemed to have been issued, after 8:00 p.m. EDT, June 18, 1987. It is applicable where a specified financial institution or a specified person in relation to any such institution has undertaken to protect a corporate shareholder with respect to the value or yield of a share. The amendments to paragraphs 112(2.2)(a) and (b) ensure that the intercorporate dividend deduction will not apply where a specified financial institution has provided a guarantee to the shareholder or a specified person in relation to the shareholder with respect to the share or dividend.

Subsection 112(2.2) as amended will also apply to a dividend on a particular share where a specified financial institution has guaranteed or insured the investment in, or return on, any share or other property that was issued or acquired and the guarantee was given as part of a transaction or event or a series of transactions or events that included the issuance or acquisition of the particular share. This ensures that this subsection will apply to dividends on shares that would not otherwise be subject to subsection 112(2.2) but are issued or acquired in conjunction with the guarantee of other shares or property.

Paragraph (c) provides that subsection 112(2.2) does not apply to a dividend received on a share that is not a term preferred share because it has been issued by a corporation in financial difficulty. Under new paragraph (d) amended subsection 112(2.2) will not apply with respect to dividends received on a prescribed share, a taxable preferred share issued before December 16, 1987 or a grandfathered share. However subsection 112(2.2), as it read before June 18, 1987, may apply to dividends received on a grandfathered share.

New paragraph (e) continues the exception provided by existing paragraph 112(2.2)(d) from the application of subsection 112(2.2) for publicly listed shares issued by a specified financial institution where all guarantee agreements in respect of these shares are given by the issuer or persons related thereto unless the shareholder and persons with whom the shareholder does not deal at arm's length (otherwise than by reason of a right referred to paragraph 251(5)(b)) receive dividends in respect of more than 10% of the guaranteed shares.

The changes to subsection 112(2.2) will generally apply only to dividends received on shares (other than grandfathered shares) issued after 8:00 p.m. EDT, June 18, 1987. However, amended subsection 112(2.2) will also apply to a share issued before that time where a guarantee in respect of the share has been provided after that time. New paragraph 112(2.2)(f) treats the share as having been issued at the time that such guarantee was provided.

New paragraph 112(2.2)(g) provides that for the purposes of subsection 112(2.2), the expression "specified person" in relation to a specified financial institution or to a corporate shareholder has the same meaning as provided in the definition of taxable preferred share in subsection 248(1) of the Act.

Subclause 8(3)

ITA

112(2.3)

Subsection 112(2.3) of the Act denies a deduction under subsection 112(1) or (2) to a corporation in respect of a dividend received by it on a short-term preferred share. This subsection is repealed with respect to

dividends on short-term preferred shares issued after 8:00 p.m. EDT, June 18, 1987. Such dividends are now subject to a 66 2/3% special tax under new Part VI.1. This tax is payable by the issuer corporation but may be offset through the deduction provided by new subsection 110(1)(k) against the Part I tax liability of that corporation. Reference may be made to the commentary on section 191.1(1).

Subclause 8(4)

ITA

112(2.9)

Subsection 112(2.9) of the Act prevents corporations from becoming related for the purpose of avoiding the application of subsection 112(2.4) which denies the deduction of dividends on so-called collateralized preferred shares. This amendment clarifies the application of that anti-avoidance provision.

Subclauses 8(5), (6), (7) and (8)

These set out the effective dates for the amendments to section 112 of the Act.

Clause 9

Mutual Fund Corporations

ITA

131(10)

New subsection 131(10) of the Act permits a mutual fund corporation or an investment corporation to elect not to be treated as a restricted financial institution within the meaning of that expression as defined in amended subsection 248(1) of Act. Dividends paid on shares of the mutual fund corporation or the investment corporation to a shareholder that is a restricted financial institution after this election has been made will be treated as having been paid on a term preferred share acquired in the ordinary course of business for the purposes of new subsection 112(2.1) of the Act.

This amendment is applicable after December 15, 1987, except that an election will be deemed to have been filed on time if it is filed within 6 months of the date on which the implementing legislation receives Royal Assent.

Clause 10
Dividends Received by Life Insurer
ITA
138(6)

Subsection 138(6) of the Act provides that, in computing the taxable income of a life insurer, taxable dividends received from taxable Canadian corporations (other than dividends on certain term preferred shares) may be deducted. Subsections 112(2.2) and (2.4), however, deny any deduction under subsection 138(6) with respect to certain dividends on so-called collateralized preferred shares and on shares the value or yield of which is guaranteed. The amendment to subsection 138(6) clarifies that no deduction may be made under subsection 138(6) where subsection 112(2.2) or (2.4) applies. This amendment is applicable with respect to dividends received after 8:00 p.m. EDT, June 18, 1987.

Clause 11
Instalments

Subclauses 11(1) and (2)
ITA
157(1)

Subparagraph 157(1)(a)(i) of the Act contains part of the formula by which a corporation calculates its Part I income tax instalments.

Subparagraph 157(1)(a)(i) is amended to integrate the instalment requirements for tax payable under Part I and new Part VI.1. This change is necessary because new Part VI.1 tax payable on dividends for a year may offset Part I tax payable on income for that year. The amendment will ensure that a corporation's Part I tax instalments for a year are not inappropriately reduced where Part VI.1 tax is payable for the year. Absent this change, in the first year Part VI.1 tax was payable by a corporation, it could estimate its Part I tax payable for the year after claiming a deduction under paragraph 110(1)(k) in computing its taxable income of 2 1/2 times its Part VI.1 tax payable for the year. As a result, the corporation's Part I tax instalments for the year might be reduced while its Part VI.1 tax instalments would be nil since it had no Part VI.1 payable for the preceding year.

An amendment to paragraph 157(1)(b) combines Part I and Part VI.1 tax for purposes of determining the remainder of tax payable by a corporation at the final tax payment date for a year. Consequential changes to Income Tax Regulation 5301 combine Part I tax and the new Part VI.1 tax for the purposes of determining the first and second instalment bases referred to in subparagraphs 157(1)(a)(ii) and (iii).

The amendments to paragraphs 157(1)(a) and (b) apply to the 1988 and subsequent taxation years.

Subclause 11(3)

ITA

157(2)

Subsection 157(2) of the Act is amended to provide that the relief from the instalment obligations for a year of a credit union with taxable income not exceeding \$10,000 will apply only where it has no Part VI.1 tax for the year or the preceding year.

Subclause 11(4)

ITA

157(2.1)

Subsection 157(2.1) of the Act is amended to provide that the relief from the instalment provisions for a corporation with Part I tax payable or a first instalment base not exceeding \$1,000 for a year be amended to add a reference to the corporation's Part VI.1 tax for the year.

Subclause 11(5)

This sets out the effective dates for the amendments to section 157 of the Act, all of which are applicable to the 1988 and subsequent taxation years.

Clause 12

Interest on Unpaid Taxes

ITA

161

Section 161 imposes interest on late or deficient instalment payments of tax or other amounts payable under the Act.

Subclause 12(1)

ITA

161(3)

Subsection 161(3) of the Act imposes an additional 3% interest on a credit union which did not pay instalments in a taxation year where it is subsequently found that the relief provided by subsection 157(2) was not available.

The amendment to subsection 161(3) is consequential on the amendment to subsection 157(2). By virtue of this amendment, the 3% additional interest will also be payable where a credit union has relied on

subsection 157(2) in order not to pay instalments and it is subsequently found that it has Part VI.1 tax payable for the year. This amendment is applicable to the 1988 and subsequent taxation years.

Subclause 12(2)

ITA

161(4.1)(a)

Subsection 161(4.1) of the Act charges interest on the late or deficient instalments of a corporation based on its actual Part I tax payable for the year. Paragraph 161(4.1)(a) is amended to add a reference to the Part VI.1 tax payable by the corporation for the year. This change is consequential on the amendments to section 157 that integrate the instalment requirements for the taxes payable under Part I and new Part VI.1.

The amendment to paragraph 161(4.1)(a) is effective for the 1988 and subsequent taxation years. However, where the 1988 taxation year commences in 1987, interest on late or deficient instalments will be determined as if Part VI.1 tax were not payable by the corporation for the year. Therefore, no interest will be charged for a taxation year commencing before 1988 if the payment of Part VI.1 tax is made on the final date on which the tax payment for the year becomes payable. In addition, for such year, the effect of the deduction under new paragraph 110(1)(k) on the computation of a corporation's Part I tax instalments is ignored.

Clause 13

Part IV

The purpose of Part IV of the Act is to prevent the deferral of tax by an individual on portfolio dividend income through the use of a private or closely-held corporation. While dividends received by individuals are subject to tax in their hands, corporations are generally permitted under section 112 to deduct dividends received in computing their taxable income. To counter the incentive for individuals to defer tax on their dividend income by transferring their portfolio shareholdings to a corporation, Part IV imposes a refundable tax on portfolio dividends received by private and other closely-held corporations. This tax is refunded to the corporation when taxable dividends are distributed to its shareholders since individual shareholders will then be subject to tax on the distribution.

Subclause 13(1)

ITA

186(1)(b)

Where a corporation that has paid tax under Part IV or has paid refundable taxes on other investment income subsequently pays taxable dividends, it is entitled to a refund of such taxes. Where such dividends are received

by a connected corporation, paragraph 186(1)(b) imposes Part IV tax on the receipt of the dividend in an amount calculated by reference to the dividend refund in respect thereof obtained by the corporation that paid the dividend.

Subsection 112(2.4) and new subsection 112(2.2) of the Act apply in certain circumstances to deny the intercorporate dividend deduction in respect of dividends received by a corporation. Where this occurs Part IV tax should not apply since the corporation is fully taxed on these dividends under Part I of the Act. The amendment to paragraph 186(1)(b) excludes taxable dividends received from a connected corporation from the base on which Part IV tax is calculated in those circumstances where the dividend is not deductible under subsection 112(1) of the Act. A similar exclusion is provided in existing paragraph 186(1)(a) for non-deductible dividends received from a non-connected corporation. This amendment to paragraph 186(1)(b) is applicable to dividends received after June 18, 1987.

Subclause 13(2)

ITA

186(1.1)

New subsection 186(1.1) of the Act is consequential on the addition of new Part IV.1 which imposes a 10% tax on certain dividends received by certain corporations. The taxes under both Part IV and Part IV.1 can apply with respect to the same dividend received by a corporation. New subsection 186(1.1) provides that where a dividend is subject to tax under both Parts, the Part IV.1 tax payable on the dividend will be deducted from the Part IV tax otherwise payable on the same dividend. This amendment is applicable to dividends received after June 18, 1987.

Subclause 13(3)

ITA

186(6)

New subsection 186(6) of the Act sets out rules that clarify, for purposes of Part IV, the tax treatment of dividends received by partnerships for fiscal periods ending after June 18, 1987. These rules provide for the flow-through to partners of dividends received by a partnership. For the purposes of the Part IV tax, each partner is considered to own the same proportion of a corporation's shares that were owned by a partnership in a fiscal period as the proportion of the amount of the dividends received by the partnership that is included in the partner's income is of the dividends received by the partnership on such shares in that period. This amendment is applicable with respect to fiscal periods ending after June 18, 1987.

Subclauses 13(4) and (5)

These set out the effective dates for the amendments to section 186 of the Act.

Clause 14
Part IV.1

New Part IV.1 of the Act provides for two special taxes to be paid by certain corporations on dividends received by them after 1987 on a taxable preferred share or a taxable RFI share as those expressions are defined in subsection 248(1) of the Act.

Subclause 14(1)
ITA
187.1 and 187.2

New subsection 187.2 of the Act imposes a special 10% tax on dividends, other than excepted dividends, received by a corporation on a taxable preferred share other than a share of a class subject to the special election provided in subsection 191.2(1). This tax applies with respect to dividends received after 1987, or deemed by subclause 14(2) to have been received after 1987, and must be paid by the corporation on or before the last day of the second month following the end of its taxation year. A taxable preferred share is defined in subsection 248(1) to include most preferred shares issued after 8:00 p.m. EDT, June 18, 1987.

The special 10% tax is payable on dividends on taxable preferred shares in respect of which the recipient corporation may claim an intercorporate dividend deduction under section 112 or 113 or under subsection 138(6) in computing its taxable income for the year other than dividends on taxable preferred shares where the corporation paying the dividends has made a special election in respect of the relevant class of shares under new subsection 191.2(1). Reference may be made to the commentary on that provision.

This special tax does not apply to excepted dividends. An excepted dividend is defined as any dividend that comes within one or more of the following categories:

- a dividend received by a corporation on a share of a foreign affiliate where the share was not acquired in the ordinary course of its business,
- a dividend received by a corporation on a share of another corporation in which it has (or would have, if that other corporation were a taxable Canadian corporation) a substantial

interest at the time the dividend was paid, unless the other corporation is described in paragraphs (a) to (f) of the definition "financial intermediary corporation" in subsection 191(1),

- a dividend received by a corporation at a time when it was a private corporation,
- a dividend received by a corporation at a time when it was a financial intermediary corporation (this expression is defined in subsection 191(1) and reference may be made to the commentary on that provision), and
- a dividend received on a short-term preferred share (as defined in amended subsection 248(1) of the Act), except where the dividend is an "excluded dividend" described in paragraph (b) or (c) of the definition of that term in subsection 191(1).

For the purpose of this definition new subsection 191(2) applies to determine whether a corporation has a substantial interest in another corporation. Generally, a corporation is considered to have a substantial interest in another corporation if it is related to the other corporation or if it owns 25% or more, in terms of votes and value, of the shares of the other corporation.

Tax on dividends on taxable RFI shares

ITA

187.3

New subsection 187.3(1) of the Act levies a special 10% tax on dividends, other than excepted dividends, received by a restricted financial institution on a taxable RFI share that is acquired after 8:00 p.m. EDT, June 18, 1987. The tax applies to dividends received after 1987, or deemed by subclause 14(2) to have been received after 1987, in respect of which the institution may claim an intercorporate dividend deduction under subsection 138(6) or under section 112 or 113 in computing its taxable income for the year. The tax payable by an institution for a taxation year must be paid on or before the last day of the second month following the end of that year.

This special tax applies only to restricted financial institutions. The definition in subsection 248(1) of "restricted financial institution" includes a bank, trust company, credit union, insurance corporation, a corporation whose principal business is the lending of money to persons with whom the corporation is dealing at arms length or a corporation controlled by one or more such corporations. A taxable RFI share is defined in subsection 248(1) to include most preferred shares that were issued before 8:00 p.m. EDT, June 18, 1987 that are not term preferred shares. However, an important exception in the taxable RFI share definition will permit a restricted financial institution to be exempted

from the 10% tax on dividends received on shares acquired after June 18, 1987 that would otherwise be taxable RFI shares provided it does not acquire shares in excess of certain threshold amounts. Reference may be made to the commentary under the definition of taxable RFI shares.

The 10% tax is not payable by a restricted financial institution on an "excepted dividend" as that expression is defined in section 187.1. Reference may be made to the commentary on that provision.

New subsection 187.3(2) of the Act contains a number of grandfathering provisions with respect to the acquisition of taxable RFI shares after 8:00 p.m. EDT, June 18, 1987. This subsection treats a share that is acquired by a person or partnership after 8:00 p.m. EDT, June 18, 1987 as having been acquired before that time and thus not subject to the new tax under section 187.3, where

- the share was acquired pursuant to an agreement in writing entered into before that time;
- the share was acquired as part of a distribution to the public made in accordance with the terms certain documents filed with a public authority before that time;
- the share was acquired on the conversion of a share or debt obligation issued before that time and its terms and conditions were established in writing before that time;
- the share is a share of a Canadian corporation listed on a stock exchange in Canada and was acquired on the exercise of a right, such as a warrant, that was similarly listed and the terms and conditions of the share were established in writing before that time; or
- the share was acquired from a related restricted financial institution in the circumstances outlined in new paragraph 187.3(2)(e) or by reason of an amalgamation of two or more corporations described in any of paragraphs (a) to (d) of the definition "restricted financial institution" in the circumstances outlined in new paragraph 187.3(2)(f).

Partnerships

ITA

187.4

New section 187.4 of the Act sets out rules that clarify for the purposes of new Part IV.1 the tax treatment of dividends received by partnerships after 1987. These rules provide for the flow-through to partners of dividends received by a partnership. Each partner is considered to own a

proportion of the shares that were owned by the partnership in a fiscal period based on the proportion of the dividends received by the partnership on such shares in the period that is included in computing the partner's income. They also provide that a reference to a person in Part IV.1 includes a partnership.

Information return

ITA

187.5

New section 187.5 of the Act requires a corporation, liable for tax under new Part IV.1 for a taxation year, to file a return in prescribed form containing an estimate of its tax payable under sections 187.2 and 187.3 for the year.

Provisions applicable to Part

ITA

187.6

New section 187.6 of the Act provides that certain provisions of Part I relating to assessments, penalties, objections and appeals are applicable for the purposes of the taxes payable under Part IV.1.

Subclause 14(2)

Subclause 14(2) provides that the new Part IV.1 tax is applicable with respect to dividends received after 1987. It also treats dividends received after December 15, 1987, but before 1988, as having been received on January 1, 1988 where it may reasonably be considered that these dividends were paid at that time to avoid or limit the application of the new Part IV.1.

Clause 15

Part VI.1

New Part VI.1 of the Act provides for a special tax to be paid with respect to dividends, other than excluded dividends, paid by corporations after 1987 on taxable preferred shares. The purpose of this tax is to make the tax system more neutral as between debt and preferred share financing. The Part VI.1 tax may be offset against tax payable under Part I of the Act by way of a deduction provided by new paragraph 110(1)(k) so that the overall tax liability for those corporations with Part I tax payable will remain largely unaffected by the Part VI.1 tax. As explained below, a \$500,000 annual dividend allowance will exempt from the tax dividends on preferred shares paid by most small corporations.

Definitions

ITA

191(1)

New subsection 191(1) defines certain expressions used in new Part VI.1.

Excluded dividends on taxable preferred shares are not subject to the Part VI.1 tax. The term excluded dividends means:

- dividends paid to a shareholder who had a substantial interest in the payer corporation when the dividend was paid;
- dividends paid by a corporation that was a financial intermediary corporation or a private holding corporation when the dividend was paid;
- dividends paid by a corporation that would, under certain conditions, have been a financial intermediary corporation;
- dividends paid by a mortgage investment corporation;
- capital gains dividends paid by mutual fund corporation.

Dividends paid by a financial intermediary corporation are not subject to Part VI.1 tax. The expression "financial intermediary corporation", also used in new Part IV.1, includes:

- a corporation licensed to issue investment contracts, as described in clause 146(1)(j)(ii)(B);
- an investment corporation;
- a mortgage investment corporation;
- a mutual fund corporation;
- a prescribed venture capital corporation, or
- a prescribed labour-sponsored venture capital corporation.

Such a corporation will not be a financial intermediary corporation, however, if it is a prescribed corporation, or

- a corporation that is controlled by or for the benefit of one or more corporations that are not financial intermediary corporations or private holding corporations, except where such controlling corporations do not own more than 10%, in value, of all the issued and outstanding shares of the corporation, or

- any corporation in which another corporation other than a financial intermediary corporation or a private holding corporation has a substantial interest unless the other corporation and specified persons in relation thereto do not own more than 10%, in value, of all the issued and outstanding shares of the corporation.

Part VI.1 also does not apply to dividends paid by a private holding corporation. The expression "private holding corporation" is defined as a corporation that does not own shares of another corporation (except another private holding corporation) in which it has a substantial interest and the only undertaking of which is the investment of its funds. Such a corporation will not be a private holding corporation, however, if it is a specified financial institution (as defined in subsection 248(1)) or a corporation that is controlled in any manner whatever by one or more corporations other than private holding corporations, or in which a corporate shareholder other than a private holding corporation has a substantial interest.

Substantial interest

ITA

191(2) and (3)

New subsection 191(2) of the Act describes the circumstances in which a shareholder will be treated as having a substantial interest in a corporation. A shareholder has a substantial interest in a corporation where the shareholder is related to the corporation (otherwise than by reason of a right referred to in paragraph 251(5)(b)) or where the shareholder owns shares of that corporation representing, in terms of votes and value, 25% or more of its issued shares and, as well, common shares representing at least 25% of the fair market value of all common shares. For the purpose of subsection 191(2) shares owned by persons related to a shareholder are considered to be owned by the shareholder.

New paragraphs 191(3)(a), (c) and (d) deem a person not to have a substantial interest in a corporation where

- it is reasonable to consider that the principal purpose for acquiring the interest in the corporation was to avoid or limit the application of Part IV.1 or VI.1,
- the shareholder is a corporation described in paragraphs (a) to (f) of the definition "financial intermediary corporation" in subsection 191(1) that is not related to the corporation, or
- the shareholder is a partnership or trust except a trust that has only one beneficiary or in which all the beneficiaries are related to each other (for this purpose any individual and his or her descendants are considered to be related to the individual's aunt, uncle, niece or nephew and his or her descendants).

In addition, new paragraph 191(3)(b) provides that where a person with a substantial interest in a corporation has acquired a share of the corporation from a shareholder who does not have a substantial interest in order to avoid tax under Part IV.1 or VI.1 the acquiror will be deemed not to have a substantial interest in the corporation with respect to any dividend paid on the share.

Reorganizations

ITA

191(4) and (5)

New subsections 191(4) and (5) of the Act provide that the Part VI.1 tax and tax payable under section 187.2 do not apply with respect to certain deemed dividends and that such dividends will not be denied the intercorporate dividend deduction by reason of subsection 112(2.1) or 138(6).

Subsection 84(3) of the Act provides that where a corporation resident in Canada has paid an amount on the redemption, acquisition or cancellation of a share of its capital stock, a dividend equal to the excess of the amount paid over the paid-up capital of the share is deemed to have been paid by the corporation and received by the shareholder. Subsection 84(2) provides a similar rule with respect to amounts distributed or otherwise appropriated on the winding-up, discontinuance or reorganization of the business of a corporation.

New subsection 191(4) applies with respect to a deemed dividend arising under subsections 84(2) and (3) of the Act on the redemption, acquisition or cancellation of a share where

- the share was issued in the course of a reorganization and the share was specified to be redeemed, acquired or cancelled for an amount equal to the value of the consideration for which the share was issued;
- the share was not issued to raise capital or for any purpose other than the reorganization (for this purpose a share issued in the course of a reorganization described in paragraph 55(3)(b), i.e. a "butterfly" reorganization, will not be considered to have been issued to raise capital)
- the share was not issued in consideration for a taxable preferred share or for a share that is considered to be a term preferred share because it is owned by a financial institution that controls the issuer.

In these circumstances the Part VI.1 tax and the tax payable under section 187.2 will not apply to the deemed dividend unless the amount paid on the redemption, acquisition or cancellation of the share exceeds the specified amount.

New subsection 191(5) also provides an exemption from the new Part VI.1 tax and the tax payable under section 187.2 for dividends paid on taxable preferred shares in circumstances where a deemed dividend arises under subsection 84(2) or (3) on the redemption, acquisition or cancellation of a share. This exemption applies where the terms and conditions of a share are changed or established or an agreement in respect of that share is changed or entered into so that that share will subsequently be redeemed, acquired or cancelled for a specified amount. In these circumstances the Part VI.1 tax and the tax payable under section 187.2 will not apply to the deemed dividend unless the amount paid on the redemption, acquisition or cancellation of the share exceeds the specified amount.

Tax payable

ITA

191.1(1)

New subsection 191.1(1) of the Act provides for a tax to be paid by a corporation that has paid taxable dividends on taxable preferred shares. This tax applies to dividends, other than excluded dividends, paid after 1987, or deemed by subclause 15(3) to have been paid after 1987. The tax is payable by way of monthly instalments, as provided by amended subparagraph 157(1)(a)(i). Reference may be made to the commentary on that provision.

The tax to be paid under paragraph 191.1(1)(a) is equal to 66 2/3% of the amount by which the taxable dividends (other than excluded dividends) paid by the corporation in the year on short-term preferred shares exceed the corporation's dividend allowance for the year. As discussed in the commentary on the definition of short-term preferred share in subsection 248(1), short-term preferred shares are shares which are retractable or could be required to be redeemed within 5 years of issue. Since short-term preferred shares may be considered to be debt-substitutes, the rate of 66 2/3% is intended to approximate the amount of tax that may be paid on an equivalent amount of interest assuming a 40% rate of corporate tax.

Where taxable dividends are paid by a corporation on its taxable preferred shares (defined in subsection 248(1) to include most preferred shares), other than short-term preferred shares, and in respect of which no election has been made under section 191.2, the tax to be paid is equal to 25% of the amount by which these taxable dividends exceed the corporation's dividend allowance for the year.

Where the corporation has made an election under subsection 191.1(2) in respect of a class of its taxable preferred shares, the rate of this tax will be 40%. Reference may be made to the commentary on subsection 191.2(1) relating to this election.

Under new subsection 191.3(1) two corporations may agree that one of them may transfer its liability for Part VI.1 tax to the other provided that the two corporations are related. The purpose of this provision is described in the commentary on that subsection. Where such an agreement is made, the agreed amount will be added to the Part VI.1 tax payable by the transferee and will reduce the Part VI.1 tax payable by the transferor.

New Part VI.1 tax is not payable in respect of excluded dividends as defined in subsection 191(1). These include dividends paid to a shareholder who had a substantial interest in the payer corporation when the dividend was paid, dividends paid by a corporation that was a financial intermediary corporation or a private holding corporation when the dividend was paid, dividends paid to certain shareholders by a corporation that would, under certain conditions, have been a financial intermediary corporation, dividends paid by a mortgage investment corporation and capital gains dividends.

The Part VI.1 tax is payable only in respect of dividends (other than excluded dividends) paid on taxable preferred shares by the corporation in excess of its dividend allowance for the year. As explained in the commentary under subsection 191.1(2), the dividend allowance for a taxation year of a corporation or corporate group is \$500,000 less the amount of non-excluded dividends paid by the corporation in the preceding calendar year in excess of \$1,000,000.

Dividend allowance
ITA
191.1(2) to (6)

A corporation will generally pay tax under Part VI.1 only on dividends on taxable preferred shares (other than excluded dividends) paid by it in excess of its dividend allowance. New subsections 191.1(2) to (6) of the Act set out the rules applicable for the computation of a corporation's dividend allowance. These rules parallel the rules used in determining a corporation's business limit for the purposes of the small business deduction under section 125.

New subsection 191.1(2) determines a corporation's dividend allowance for a taxation year to be \$500,000 where the corporation is not associated with another corporation in the year. This amount, however, is subject to a clawback that reduces it on a dollar-for-dollar basis by the amount of non-excluded dividends in excess of \$1,000,000 paid in the

preceding calendar year by the corporation on its taxable preferred shares or shares that would have been taxable preferred shares if they had been issued after June 18, 1987.

New subsections 191.1(3), (4) and (5) of the Act apply for the purpose of determining the dividend allowance of associated corporations. A total dividend allowance is first determined for a group of associated taxable Canadian corporations. Under subsection 191.1(4), this total dividend allowance is \$500,000 less the excess over \$1,000,000 of non-excluded dividends paid in the preceding calendar year by the corporations in that group on taxable preferred shares or shares that would have been taxable preferred shares if they had been issued after June 18, 1987. These corporations may then allocate the total dividend allowance among the group by filing a prescribed agreement under new subsection 191.1(3) of the Act. If such agreement is not filed by any corporation in the group that has paid dividends on taxable preferred shares in the year, the Minister of National Revenue may make the allocation under new subsection 191.1(5).

New paragraph 191.1(6)(a) of the Act applies to all corporations, whether or not associated, and requires a proration of the dividend allowance for any taxation year of less than 51 weeks duration. It provides that a corporation's dividend allowance for a short taxation year is its dividend allowance otherwise determined multiplied by the number of days in the year and divided by 365.

New paragraph 191.1(6)(b) of the Act is applicable where a corporation has two or more taxation years ending in the same calendar year in which it is associated with another corporation. This rule provides that the corporation's dividend allowance (before proration for the short year) for each such taxation year is the amount allocated to it for its first such taxation year under subsection 191.1(3). The corporation's dividend allowance for each such year is then determined after the required proration pursuant to new paragraph 191.1(6)(a).

Election
ITA
191.2

The rate of Part VI.1 tax on dividends paid on taxable preferred shares (other than short-term preferred shares) of a class in respect of which a corporation has made an election under new section 191.2 is 40% instead of 25%. The effect of the election to pay the 40% is to enable shareholder corporations to receive dividends without being subject to the 10% tax under Part IV.1.

An election may be made by a taxable Canadian corporation in respect of a class of its taxable preferred shares only if the terms and conditions of the shares require that this election be made. According to new

section 191.2, the election is to be made by filing a prescribed form with the Minister of National Revenue not later than the date on which a tax return must be filed by the corporation under Part I for the taxation year in which shares of that particular class of shares are first issued or first become a taxable preferred share or within 90 days of the mailing of a notice of assessment for that year. A special transitional rule is provided in subclause 15(4) to allow elections to be filed at any time within 6 months from the date on which the implementing legislation receives Royal Assent.

Agreement respecting liability for tax

ITA

191.3

New section 191.3 of the Act allows a corporation that would otherwise be liable to pay tax under Part VI.1 in a taxation year (a transferor corporation) and a related corporation (a transferee corporation) to file an agreement whereby all or a portion of the Part VI.1 tax liability is transferred to the transferee corporation. This will prove advantageous to holding corporations that do not pay Part I tax against which they can offset the Part VI.1 tax through the special deduction provided by paragraph 110(1)(k).

An agreement to transfer tax otherwise payable under Part VI.1 by a transferor corporation will be valid only if the transferee corporation was related to the transferor throughout that taxation year of the transferor corporation and also throughout the last taxation year of the transferee corporation ending at or before the end of that taxation year of the transferor corporation.

Under new subsection 191.3(2) an agreement or amended agreement must be filed by the transferor corporation and the transferee corporation with the Minister of National Revenue in prescribed form no later than the day on which the transferor corporation's tax return under Part I is required to be filed for its taxation year in which Part VI.1 tax would otherwise be payable by it. An agreement or amended agreement may also be filed within 90 days of the day of mailing of a notice of assessment (or notification that no tax is payable) to the transferor corporation or the transferee corporation for the taxation year in respect of which the agreement is filed. Subsection 191.3(2) also requires the agreement to be accompanied by a certified copy of a resolution of the directors (or the persons legally entitled to administer the affairs of the corporation) of both the transferor and transferee corporation authorizing the agreement.

New subsection 191.3(3) imposes on the Minister of National Revenue the duty to assess the transferor and transferee corporations according to an agreement or amended agreement even where the three-year limit provided by subsections 152(4) and (5) might otherwise apply.

New subsection 191.3(4) is an anti-avoidance provision that prevents a corporation from becoming related to another corporation in order to transfer its Part VI.1 tax liability to the related corporation through a subsection 191.3(1) election. Absent such a rule, this election would allow the corporation to effectively avoid the payment of the Part VI.1 tax since the deduction allowed by subsection 110(1)(k) would allow the related corporation to offset the Part VI.1 tax so transferred against its Part I tax payable.

The amount of tax specified in the agreement filed in accordance with section 191.3 will be included in the Part VI.1 tax payable by the transferee corporation and will be deducted from the amount of Part VI.1 tax otherwise payable by the transferor corporation. Both corporations remain jointly and severally liable to pay the tax and the interest and penalties in respect thereof. Thus, new subsection 191.3(5) permits the Minister to assess the transferor corporation in respect of the agreed amount of tax and provides that certain provisions of Part I relating to assessments, penalties, objections and appeals are then applicable.

New subsection 191.3(6) provides that where payment is made by the transferor corporation on account of this joint liability, the joint liability is reduced accordingly. However, any payment by the transferee corporation will reduce the transferor corporation's liability only to the extent of the excess, if any, of the amount paid over the transferee corporation's remaining liability under the Act after the payment. In effect, this treats a tax payment by the transferee corporation as applying first against its other tax liabilities under the Act.

Information return

ITA

191.4

New subsection 191.4(1) of the Act requires a corporation liable for any tax under new Part VI.1 for a taxation year to file a return containing an estimate of its tax payable for the year. The return is to be filed on or before the date by which its Part I corporate tax return is required to be filed.

New subsection 191.4(2) of the Act provides that certain provisions of Part I relating to assessments, penalties, objections and appeals are applicable to the tax under Part VI.1.

Subclauses 15(2) to (4)

The Part VI.1 tax is applicable to the 1988 and subsequent taxation years but only with respect to dividends paid after 1987. For that purpose, subclause 15(3) provides that dividends paid after December 15, 1987,

but before 1988, are treated as having been paid on January 1, 1988 where it may reasonably be considered that these dividends were paid to avoid or limit the application of the new Part VI.1.

A special provision applies with respect to elections under new subsection 191.2 of the Act. Since, in some cases, such elections may be required to be filed before the enactment of new subsection 191.2, subclause 15(4) provides that an election will be deemed to have been filed on time if it is filed within 6 months of the date on which the implementing legislation receives Royal Assent.

Clause 16
Application to other Parts
ITA
227(14)

Subsection 227(14) of the Act provides that a corporation is not liable to tax under Part III, IV or VI of the Act for any period of time during which it was exempt from Part I tax by reason of section 149 of the Act. This provision is amended effective for the 1988 and subsequent taxation years as a consequence of the introduction of new Parts IV.1 and VI.1 to provide that those new Parts do not apply to any corporation for any period throughout which it is tax-exempt under section 149.

Clause 17
Definitions
ITA
248(1)

Subsection 248(1) of the Act defines many of the terms used in the Act.

Subclause 17(1)
"Short-term preferred share"

The definition "short-term preferred share" is to be amended with respect to shares issued after December 15, 1987.

Under existing subsection 112(2.3) of the Act dividends received by a corporation on a short-term preferred share are not deductible in computing its taxable income unless the corporation does not deal at arm's length with the dividend-paying corporation. In general, a share which was issued in lieu of commercial paper or short-term debt and that may be retracted within 18 months of its issue falls within the existing definition short-term preferred share.

Subsection 112(2.3) is repealed with respect to dividends paid on short-term preferred shares issued after December 15, 1987. Dividends paid on such shares (other than grandfathered shares) issued after that time will be subject to a 66 2/3% special tax provided by new Part VI.1.

The amended definition of short-term preferred share generally applies to shares issued after December 15, 1987. The condition that the share be issued in lieu of commercial paper or short-term debt is no longer included in the definition. In addition, under paragraph (a), the 18-month retraction period is extended so that a share will be a short-term preferred share if the issuing corporation or a specified person in relation to the issuer may under the terms of the share or an agreement in respect of the share be required to redeem, acquire or cancel the share or to reduce its paid-up capital within 5 years of the date of issue. A share will not be a short-term preferred share by reason only of paragraph (a) if the requirement to redeem, acquire or cancel the share arises solely in the event of the death of the shareholder or a shareholder of the shareholder or on a conversion or exchange of the share. An agreement to acquire a share for an amount that does not exceed its fair market value at the time of the acquisition will not in itself cause a share to be a short-term preferred share.

Paragraph (b) of the new definition provides that a short-term preferred share also includes a share that is convertible or exchangeable within 5 years from the date of its issue except in those circumstances where the share of a corporation is convertible or exchangeable only into a share of the corporation or a related corporation that if issued would not be a short-term preferred share, or into a right or warrant to acquire such a share that is not a short-term preferred share, and all the consideration receivable upon the conversion or exchange is the share, right, warrant or a combination thereof.

Paragraphs (c) to (j) of the new definition provide a number of supplementary rules.

The amended definition of short-term preferred share applies only to shares issued after December 15, 1987. However, where the terms or conditions of a share (or any agreement in respect of that share) relating to the share's redemption, acquisition, cancellation, conversion or reduction of its paid-up capital, are established or changed after that time, paragraph (c) will treat the share as having been issued at that later time.

Paragraph (d) is similar to paragraph (h) of the existing short-term preferred share definition. This paragraph anticipates the possibility that a share may be issued in combination with a debt obligation or another short-term preferred share in order to circumvent the new Part VI.1 tax. Where one of the main purposes of the issue of the share or modification of its terms and conditions is to avoid or limit the taxes payable under new Part VI.1, this paragraph treats the share as a short-term preferred share.

Paragraph (e) treats a share as a short-term preferred share if, after December 15, 1987, the terms of the share are established or modified or any agreement in respect of the share has been changed or entered into so that it is reasonable to expect that the share will be redeemed within 5 years of its date of issue. This might apply, for example, in the case of a redeemable share issued for an indefinite term but on which the rate of dividends or redemption premium is scheduled to increase sharply at some time within 5 years from its date of issue. In this case the share could reasonably be expected to be redeemed before any such increase would take effect. In circumstances where the reasonable expectation ceases to exist, for example, where the term providing for an increase in the rate of dividends is deleted, this paragraph ceases to treat the share as a short-term preferred share.

Paragraph (f) treats a share as a short-term preferred share in circumstances where there is an arrangement under which the issuing corporation will dissolve or wind-up within 5 years from the date on which the share was issued unless the share is a grandfathered share and the arrangement is a written arrangement entered into before December 16, 1987.

Paragraph (g) applies where a share issued by a corporation is originally acquired by a specified person in relation to the corporation and is subsequently acquired by an arm's length party. In this situation, for the purposes of the 5-year test, the share is treated as having been issued at the time of the subsequent acquisition.

Paragraph (h) of the definition will treat a share as a short-term preferred share where any person (other than the issuing corporation or an individual) has undertaken in an agreement to which the issuing corporation or a specified person in relation thereto is a party to guarantee all or part of the shareholder's investment against any loss that he may suffer within 5 years of the issuance or acquisition issue of the share. For the purpose of this rule, the share is treated as having been issued at the time the guarantee agreement is given.

Paragraph (i) excludes from the definition of short-term preferred share a prescribed share and a share issued by a corporation in financial difficulty (described in paragraph (e) of the definition "term preferred share").

Paragraph (j) provides that the expression specified person has the meaning assigned to it by paragraph (h) of the definition of taxable preferred share and means any person with whom the corporation does not deal at arm's length or any partnership or trust of which the corporation or any such other person is a member or beneficiary.

The new definition of short-term preferred share applies with respect to shares issued or deemed to have been issued after December 15, 1987.

Subclause 17(2)

"Grandfathered share"

This amendment adds the definition "grandfathered share" to subsection 248(1) of the Act. Grandfathered shares are expressly excluded from the application of new subsection 112(2.2) and from the definitions of short-term preferred share and taxable preferred share in subsection 248(1). Under this definition a share is a grandfathered share if it is issued after 8:00 p.m. EDT, June 18, 1987 and it

- was issued pursuant to an agreement in writing entered into before that time;
- was issued as part of a distribution to the public made in accordance with certain documents filed with a public authority before that time;
- was issued on the conversion of a grandfathered share or of a share or debt obligation issued before that time where the terms and conditions of that share were established in writing before that time; or
- is a share of a Canadian corporation listed on a stock exchange in Canada and was issued on the exercise of a right or warrant that was similarly listed where the terms and conditions of that share were established in writing before that time.

However, a share ceases to be a grandfathered share if it is deemed to have been issued at any time after June 18, 1987 under subsection 112(2.2) or under the definition of "short-term preferred share" or "taxable preferred share".

"Restricted financial institution"

This amendment adds the definition "restricted financial institution" to subsection 248(1) of the Act. This definition is used for the purpose of the new Part IV.1 tax on taxable RFI shares. A restricted financial institution includes a bank, trust company, credit union, insurance corporation, a corporation whose principal business is the lending of money to persons with whom the corporation is dealing at arms length or a corporation controlled by one or more such corporations. Unlike the definition of "specified financial institution", however, this definition does not include a corporation which is related to, but not controlled by, one or more of the financial institutions listed above.

"Specified financial institution"

This amendment adds the definition "specified financial institution" to subsection 248(1) of the Act. The status of a taxpayer as a specified financial institution is relevant for the purposes of subsections 112(2.1)

and (2.2), new Parts IV.1 and VI.1 and certain other provisions of the Act. A specified financial institution includes a bank, trust company, credit union, insurance corporation, a corporation whose principal business is the lending of money to persons with whom the corporation is dealing at arms length or a corporation controlled by or related to one or more such corporations. This definition is different in two respects from that provided under existing subsection 112(2.1) of the Act. A corporation serving as an internal financing vehicle to a group of related corporations will not, in most circumstances, be considered a specified financial institution. In addition, the associated corporation rule has been replaced with a related corporation test in paragraph (g) of the definition.

"Taxable preferred share"

This amendment adds the definition "taxable preferred share" to subsection 248(1) of the Act.

This definition is relevant for the purposes the taxes imposed under new Parts IV.1 and VI.1 of the Act.

This definition includes a share that is a short-term preferred share under the definition of that expression. It also includes any share (other than a grandfathered share) that is issued after 8:00 p.m. EDT, June 18, 1987 where:

- (a) it may reasonably be considered that the amount of any dividend on that share is fixed, limited to a maximum or established to be not less than a minimum,
- (b) it may reasonably be considered that the amount that a shareholder is entitled to receive for the share upon the dissolution, liquidation or winding-up of the issuing corporation, or on the redemption, acquisition or cancellation of the share, or on a reduction of the paid-up capital in respect of the share is fixed, limited to a maximum or established to be not less than a minimum,
- (c) the share is convertible or exchangeable except in those circumstances where the share is convertible or exchangeable only into a share of the corporation or a related corporation that if issued would not be a taxable preferred share or a right or warrant to acquire such a share, and all the consideration receivable upon the conversion or exchange is the share, right, warrant or combination thereof, or
- (d) any person, other than the issuing corporation, has undertaken (in an agreement with the issuing corporation or a person related to it) to guarantee the shareholder's investment in the share (for the

purpose of this condition where such a guarantee agreement is given after 8:00 p.m. EDT, June 18, 1987 in respect of a share, the share is deemed to have been issued at that time).

Excluded from this definition are prescribed shares or shares issued by a corporation in financial difficulty (described in paragraph (e) of the definition "term preferred share").

Paragraphs (c) to (h) of the definition provide a number of supplementary rules.

Paragraphs (c) and (d) of the definition treat a shareholder's entitlement to dividends or an amount on liquidation of the issuing corporation as not being fixed, limited to a maximum or established not to be less than a minimum where such entitlement is determined by reference to the entitlement of another share of the corporation or of another corporation that controls the corporation, provided the other share would not be a taxable preferred share if this definition were read without reference to paragraph (f), the other share were issued after June 18, 1987, and the other share were not a grandfathered share, a prescribed share or a share issued by a corporation in financial difficulty.

As noted above, the definition of taxable preferred share applies only where the share was issued after 8:00 p.m. EDT, June 18, 1987. Where the terms or conditions of a share issued before that time are changed or an agreement in respect of that share is changed or entered into so as to affect any of the matters referred to subparagraphs (b)(i) to (iv), paragraph (e) will treat the share as having been issued at the time of the change for the purposes of determining whether the share is a taxable preferred share.

Paragraph (f) is a relieving provision that provides that the liquidation entitlement of a shareholder shall not be considered to be fixed, limited to a maximum or established to be not less than a minimum, solely as a result of an agreement to which the corporation or a specified person with respect to the corporation is a party, such as a shareholders' agreement, under which a purchaser agrees to acquire the share for an amount that is not greater than its fair market value at the time of the acquisition.

Paragraph (g) is an anti-avoidance rule that prevents the use of holding corporations to avoid the new Part IV.1 and VI.1 taxes. This rule deems a share to be a taxable preferred share where:

- the share is not a grandfathered share and has been issued after December 15, 1987,

- the dividends on that share may reasonably be considered to be derived primarily from dividends on taxable preferred shares of a corporation in which the issuing corporation has a substantial interest, and
- the share was issued or acquired to avoid the application of new Parts IV.1 and VI.1.

Paragraph (h) provides that the expression "specified person" used throughout the definition means any person with whom the corporation does not deal at arm's length or any partnership or trust of which the corporation or the other person is a member or beneficiary.

The amended definition of taxable preferred share applies with respect to shares issued, or deemed to be issued, after 8:00 p.m. EDT, June 18, 1987.

"Taxable RFI share"

This amendment adds the definition "taxable RFI share" to subsection 248(1) of the Act.

New section 187.3 of the Act imposes a tax of 10% on dividends received by restricted financial institutions on taxable RFI shares acquired after 8:00 p.m. EDT, June 18, 1987.

A taxable RFI share is a share issued before 8:00 p.m. EDT, June 18, 1987 or a grandfathered share where

- (a) it may reasonably be considered that the amount of any dividend on that share is either fixed, limited to a maximum or established to be not less than a minimum, or
- (b) it may reasonably be considered that the amount that a shareholder is entitled to receive for the share upon the dissolution, liquidation or winding-up of the issuing corporation, or on the redemption, acquisition or cancellation of the share is fixed, limited to a maximum or established to be not less than a minimum.

Excluded from the definition are shares which are prescribed shares, term preferred shares or shares issued by a corporation in financial difficulty as described in paragraph (e) of the definition "term preferred share".

Paragraphs (c) and (d) of the definition treat a shareholder's entitlement to dividends or an amount on liquidation of the issuing corporation as not being fixed, limited to a maximum or established to be not less than a minimum where such entitlement is determined by reference to the entitlement of another share of the corporation or of

another corporation that controls the corporation provided the other share would not be a taxable preferred share if that definition were read without reference to paragraph (f), the share were issued after June 18, 1987, and the share were not a grandfathered share, a prescribed share or a share issued by a corporation in financial difficulty.

Paragraph (e) of the definition is an anti-avoidance provision that applies where it may be reasonably be considered that the dividends on a particular share are derived primarily from dividends received on taxable RFI shares of another corporation and that the particular share was issued or acquired in order to avoid or limit the application of new Part IV.1. Where this is the case, the particular share will be treated as a taxable RFI share and the shareholder who receives dividends on such a share will be deemed not to have a substantial interest in the paying corporation.

Since taxable RFI shares cannot by definition be term preferred shares, restricted financial institutions holding such shares are generally entitled to the intercorporate dividend deduction under subsection 112(1) for dividends received on such shares. Subsection 187.3(1) imposes a 10% tax on dividends received after 1987 on taxable RFI shares acquired after 8:00 p.m. EDT, June 18, 1987 other than shares deemed to have been acquired before that date under subsection 187.3(2) (see commentary on that provision).

The definition of taxable RFI shares provides an exclusion for prescribed shares. For this purpose Regulation 6201(4) prescribes certain publicly listed shares not to be taxable RFI shares. Under that regulation a share of a class of the capital stock of a corporation will be a prescribed share at the time a dividend is received with respect to a corporation holding the share if the aggregate holdings of the corporation and restricted financial institutions with which the corporation does not deal at arm's length (referred to herein as the group) on shares of that class at that time does not exceed certain limits.

If, at the time a dividend is received by a corporation with respect to shares of a class, none of the shares of the class owned by any member of the group (other than those acquired from another member of the group) were acquired after December 15, 1987 those shares will be prescribed shares only if the total group holding at the time does not exceed 10% of the shares of that class.

If, at the time a dividend is received by a corporation with respect to shares of a class, any of the shares of the class owned by the corporation and any other member of the group (other than those acquired

from another member of the group) were acquired after December 15, 1987, those shares will be prescribed shares only if the total group holding does not exceed 5% of the shares of the class at that time.

The rule in Regulation 6201(5) provides that shares disposed of will be considered to be disposed of on a last-in, first-out basis.

Regulation 6201(7) provides rules applicable to determine whether shares may be deemed to be acquired before December 16, 1987 in the following circumstances:

- shares acquired after December 15, 1987 pursuant to an agreement in writing entered into before December 16, 1987 or as part of a public distribution made pursuant to documentation filed before December 16, 1987.
- shares acquired after December 15, 1987 by a restricted financial institution from a related restricted financial institution.
- shares acquired after December 15, 1987 by reason of an amalgamation of two or more corporations described in any of paragraphs (a) to (d) of the definition "restricted financial institution".

The definition of taxable RFI share is applicable after June 18, 1987.

Subclause 17(3)
"Amount"

The amendment to the definition "amount" in subsection 248(1) of the Act is consequential on the addition of new Part IV.1 and VI.1 to the Act relating to taxable preferred shares. The amendment adds to this definition a reference to sections 187.2, 187.3, 191.1 and subsections 258(3) and (5) for the purpose of determining the amount of a stock dividend. Thus, for the purposes of the Act, where the new Part IV.1 taxes or the special rules that deny the intercorporate dividend deduction in respect of certain shares apply with respect to a stock dividend paid by a corporation, the amount of the stock dividend will be the greater of the amount of the resultant increase in the corporation's paid-up capital and the fair market value of the shares paid as a stock dividend at the time of payment. However, where the new Part VI.1 tax provided by section 191.1 applies with respect to a stock dividend, the same rule will apply only for the purposes of Part VI.1. This amendment is applicable with respect to dividends paid after June 18, 1987.

Subclause 17(4)
"Income Bond"

The changes to subparagraphs (e)(iv) and (v) of the definition "income bond" are consequential upon the introduction of a definition of "specified financial institution" in subsection 248(1).

Subclauses 17(5) to (11)
"Term preferred share"

Subparagraph (a)(iv) of the definition "term preferred share" provides that a share will be considered a term preferred share where it is convertible into debt or another term preferred share. This conversion provision has been changed to correspond to similar conversion provisions in the definitions "short-term preferred share" and "taxable preferred share". Under new subparagraph (a)(iv), a share will be considered to be a term preferred share if it is convertible or exchangeable unless the share is convertible or exchangeable only into a share of the corporation or a related corporation that if issued would not be a term preferred share or a right or warrant to acquire such a share, and all the consideration receivable upon the conversion or exchange is the share, right warrant or combination thereof.

The amendments to paragraph (b) of the definition "term preferred share" are consequential upon the introduction of a definition of "specified financial institution" in subsection 248(1).

Paragraph (e) of the definition "term preferred share" in subsection 248(1) of the Act excludes shares issued by a corporation in financial difficulty. The amendment to subparagraph (e)(iii) of the definition, applicable to shares issued after 8:00 p.m. EDT, June 18, 1987 clarifies that if a corporation is, or is expected to be, in default on a debt obligation and a share is issued in exchange for the obligation, the share will be excluded from the definition only if all or substantially all of the share issue proceeds are used to repay all or part of the debt.

New paragraph (f.1) will exclude from this definition a taxable preferred share acquired before December 16, 1987 if this share has been issued between June 18, 1987 and December 16, 1987 (provided such shares are not deemed to have been issued after December 15, 1987 by reason of a change of their terms or conditions or by reason of an agreement being changed or being entered into). The draft legislation released on June 18, 1987 excluded taxable preferred shares from the definition of term preferred share. Taxable preferred shares issued after December 15, 1987 are not excluded from the definition "term preferred share" unless

they are acquired after December 15, 1987 and before 1989 pursuant to an agreement in writing entered into before December 16, 1987. Shares acquired before December 16, 1987 are similarly grandfathered. This amendment is applicable after June 18, 1987.

Regulation 6201 prescribes shares for the purpose of the exclusion in paragraph (f) of this definition. Under that regulation a publicly-listed share issued after 8:00 p.m. EDT, June 18, 1987 will not be a term preferred share where the corporate recipient of a dividend on the share and persons with whom that corporation does not deal at arm's length (referred to herein as the group) receive dividends in respect of not more than 10% of the issued and outstanding shares of the class (that share may, however, be a taxable preferred share). In the case of a publicly-listed share issued before 8:00 p.m. EDT June 18, 1987 or a grandfathered share, a distinction is made on the basis of the date of acquisition.

If, at the time a dividend is received by a corporation with respect to shares of the class, none of the shares of the class owned by any member of the group (other than those acquired from another member of the group) were acquired after December 15, 1987, those shares will not be a term preferred share only if the total group holding at the time does not exceed 10% of the shares of that class.

This same 10% limitation will apply for shares acquired after December 15, 1987 where the shareholder is a corporation that is not a restricted financial institution. However, if, at the time a dividend is received by a restricted financial institution with respect to shares of a class, any of the shares of the class owned by the restricted financial institution and other restricted financial institutions with which it does not deal at arms length (other than those acquired from another member of that group of restricted financial institutions) were acquired after December 15, 1987, those shares will be prescribed shares only if the total holding of the group of restricted financial institutions at the time does not exceed 5% of the shares of that class.

The changes to subparagraphs (h)(iv) to (vi) of the definition "term preferred share" are consequential upon the introduction of a definition of "specified financial institution" in subsection 248(1).

Paragraph (i.1) is an anti-avoidance provision that applies where it may be reasonably be considered that the dividends on a particular share are derived primarily from dividends received on term preferred shares of another corporation and that the share was issued or acquired in order to avoid or limit the application of subsection 112(2.1) of the Act. Where this is the case, the particular share will be treated as a term preferred share acquired in the ordinary course of business.

As noted above, the definition of term preferred share will not apply with respect to a taxable preferred share issued before December 16, 1987. Where the terms or conditions of a share issued before that time are changed or an agreement in respect of that share is changed or entered into so as to affect any of the matters referred to subparagraphs (a)(i) to (iv) of this definition, new paragraph (i.2) will treat the share as having been issued at the time of the change. This amendment is applicable after June 18, 1987.

The further amendment introduced by subclause (11) to the definition "term preferred share" deletes the rule relating to interests in trusts. This change is strictly consequential on the addition of new subsection 248(12) dealing with interests in trusts and partnerships. This amendment is applicable to shares issued after 8:00 p.m. EDT, June 18, 1987.

Subclause 17(12)

ITA

248(6)

Subsection 248(6) of the Act extends all references to a class of shares to a series of the class of shares. The amendment to that subsection clarifies that this rule also applies where a single series of a class of shares has been issued.

Subclause 17(13)

ITA

248(12)

New subsection 248(12) of the Act treats a person having a direct or indirect interest in a trust or partnership as being a beneficiary or member, as the case may be, of that trust or partnership for the purposes of a number of definitions and rules in the Act.

Subsections 112(2.1) and (2.2) of the Act deny the inter-corporate dividend deduction under subsections 112(1) and (2) with respect to certain dividends received on term preferred shares by specified financial institutions and certain dividends received by any corporation on shares guaranteed by specified financial institutions. The term "specified financial institution" is defined in amended subsection 248(1) of the Act to include financial institutions and any corporation related to a financial institution. New subsection 248(13) of the Act is an anti-avoidance rule intended to treat two or more corporations as being related for the purposes of the definition "specified financial institution" where the corporations are not otherwise related but one of the main reasons for the separate existence of the corporations may reasonably be considered to limit or avoid the application of subsection 112(2.1) or (2.2).

Subclauses 17(14) to (19)

These subclauses set out the effective dates for the amendments to section 248 of the Act.

Clause 18

Dividends on certain shares

ITA

258

Special rules are provided under the Act to disallow the intercorporate dividend deduction in respect of dividends paid on certain shares and income bonds or debentures. Section 258 complements these rules.

Subclause 18(1)

ITA

258(1)

Subsection 258(1) of the Act provides special rules for deemed dividends on term preferred shares. This provision is repealed as a consequence of the introduction of new subsection 84(4.2) to which these rules have been transferred (see commentary on that provision). This amendment is applicable with respect to reductions of paid-up capital after 1987.

Subclause 18(2)

ITA

258(3)

Subsection 258(3) of the Act treats certain dividends received on shares of non-resident corporations as interest. The amendment to that subsection simply clarifies the type of shares to which paragraph 258(3)(b) is intended to apply. This amendment is applicable to dividends received or deemed under the Act to have been received on shares acquired after 8:00 p.m. EDT, June 18, 1987.

Subclause 18(3)

ITA

258(5)

Subsections 112(2.2) and (2.4) of the Act disallow the intercorporate dividend deduction under subsections 112(1), (2) and 138(6) in respect of dividends paid on certain shares the value or yield of which is guaranteed and so-called collateralized preferred shares. In the case of such dividends received by a corporation from a foreign affiliate, the disallowance of the intercorporate deduction provided by section 113 would deprive that corporation of the relief for foreign tax paid which is built into the computation of the deduction provided by section 113. In order to prevent the corporation from claiming the deduction provided

by section 113, but, at the same time, to allow it to benefit from the foreign tax credit with respect to any foreign withholding tax on these dividends, new subsection 258(5) treats these dividends as interest for the purposes of their inclusion in the corporation's income and the computation of the foreign tax credit. This amendment is applicable after June 18, 1987.

Subclauses 18(4), (5) and (6)

This sets out the effective dates for the amendments to section 258 of the Act.