Explanatory Notes to Legislation Relating to Income Tax

Issued by
The Honourable Don Mazankowski
Minister of Finance

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Canada

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Department of Finance Canada
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These explanatory notes are provided to assist in an understanding of amendments to the Income Tax Act, the Income Tax Application Rules, 1971, the Canada Pension Plan, the Cultural Property Export and Import Act, the Income Tax Conventions Interpretation Act, the Unemployment Insurance Act and certain related Acts. These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

Cette publication est également offerte en français.

PREFACE

The legislation to which these explanatory notes relate contains amendments to the Income Tax Act, the Income Tax Application Rules, 1971, the Canada Pension Plan, the Cultural Property Export and Import Act, the Income Tax Conventions Interpretation Act, the Unemployment Insurance Act and certain related Acts. These amendments are intended to implement the income tax measures put forth in the budgets of February 20, 1990 and February 26, 1991, as well as other proposals that have been previously announced and which require changes to the Income Tax Act for their implementation. This legislation also contains a large number of technical amendments that are designed to clarify and, in some cases, correct the application of the Income Tax Act and associated statutes.

These explanatory notes describe the amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

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TABLE OF CONTENTS

Clause 1

Computation of Income

ITA
3

Section 3 of the Act provides basic rules for determining a taxpayer's income for a taxation year for the purposes of Part I of the Act. That section sets out the separate sources of income and losses that are aggregated in determining income. New paragraph 3(f), which applies to the 1990 and subsequent taxation years, is intended to clarify that where there is no excess determined under paragraph 3(d) in respect of a taxpayer for a taxation year, the taxpayer is treated as having income for that year in an amount equal to zero.

Clause 2

Source of Income or Loss

ITA
4(4)

Section 4 of the Act provides general rules for determining a taxpayer's income or loss from a particular source or from a source in a particular place. Generally, income or loss from a source or from a source in a particular place is to be computed in accordance with the Act as if the taxpayer had no other income or loss except from that particular source or from that source in the particular place. Only deductions which may reasonably considered to be wholly applicable to that source or to that source in a particular place may be claimed against income from such source.

Subsection 4(4) provides that, unless a contrary intention is evident, no provision in Part I of the Act is to be read to require the inclusion or permit the deduction of an item more than once in computing a taxpayer's income for a taxation year or his income or loss for a taxation year from a particular source or from a source in a particular place. The amendment to subsection 4(4), which applies to the 1990 and subsequent taxation years, is intended to confirm that, except where a contrary intention appears, amounts included or deducted in computing a taxpayer's income for a taxation year are not required to be included or eligible to be deducted in a subsequent year.

Clause 3

Income from Office or Employment

ITA
6

Section 6 of the Act deals with employment income and provides for the inclusion of employment-related benefits in an employee's income.

Subclause 3(1)

ITA
6(1)(a)(v)

Paragraph 6(1)(a) of the Act provides for the inclusion in an employee's income of benefits in respect of employment, with a number of specified exceptions in subparagraphs 6(1)(a)(i) to (iv).

Paragraph 6(1)(a)(v) is introduced to ensure that an employee's benefits in respect of a salary deferral arrangement (SDA) as defined in subsection 248(1) of the Act are not included as benefits under paragraph 6(1)(a), except as provided in subsection 6(11). Subsection 6(11) provides for such an inclusion for a taxation year where there are unpaid benefits accruing under the SDA at the end of the year that have not been included in income for a preceding year. Amounts actually paid out of an SDA to an employee in a taxation year are included in income under paragraph 6(1)(i), only to the extent that the aggregate of such payments exceeds amounts included for a preceding year in the income of the employee in respect of the SDA.

This amendment is applicable to the 1986 and subsequent taxation years.

Subclauses 3(2) and (3)

ITA
6(1)(b)(vii) and (vii.1)

Paragraphs 6(1)(b)(vii) and (vii.1) of the Act provide that allowances which are not in excess of reasonable amounts, in respect of travelling and motor vehicle expenses incurred in the performance of the duties of an office or employment, are not required to be included in computing the income of an individual from that office or employment. For this purpose, an allowance received by a taxpayer in the year for the use of a motor vehicle will be treated as being in excess of a reasonable amount and, therefore, taxable, where the taxpayer receives both an allowance and a reimbursement in whole or part for motor vehicle expenses in respect of the same use of the vehicle or where the measurement of the use of the vehicle for the purpose of the allowance is not based solely on the number of kilometres for which the motor vehicle is used for employment purposes.

These paragraphs are amended, applicable to the 1990 and subsequent taxation years, to provide that reasonable allowances in respect of travelling expenses and motor vehicle expenses will be excluded in computing the income of an individual from an office or employment. Thus allowances that are not reasonable, rather than only those in excess of a reasonable allowance, may be included in income. In these circumstances, the taxpayer may be entitled to a deduction with respect to travelling expenses under paragraph 8(1)(f) or (h).

Subclause 3(4)

ITA
6(1)(b)(xi)

Subparagraph 6(1)(b)(xi) of the Act provides that, where an employee receives both an allowance and reimbursement in whole or in part for motor vehicle expenses in respect of the same use of the vehicle for performing employment duties, the whole amount of the allowance will be deemed to be in excess of a reasonable amount and must, accordingly, be included in income. Where such allowances are included in the income of an employee, paragraphs 8(1)(f) and (h) may allow a deduction in respect of travelling expenses.

This subparagraph is amended as a consequence to the amendments to paragraphs 6(1)(b)(vii) and (vii.1) described above. Thus, where a taxpayer is in receipt of both a non-taxable motor vehicle allowance for the use of the vehicle in the performance of the duties of an office or employment, and is reimbursed in whole or part for expenses in respect of that use of the motor vehicle, the allowance will be deemed not to be a reasonable allowance. An exception to this rule applies for reimbursements in respect of supplementary business insurance or parking, toll or ferry charges and the allowance has been determined without reference to such reimbursed expenses.

This amendment is applicable to the 1988 and subsequent taxation years, except that it is not applicable to the 1988 and 1989 taxation years of an individual who so elects by notifying the Minister in writing.

Subclause 3(5)

ITA
6(16)

New subsection 6(16), which is applicable to the 1991 and subsequent taxation years, provides for the exclusion from income of employer-provided benefits relating to the transportation to and from work (including parking near the work location) of blind employees and employees who have a severe and prolonged mobility impairment. Likewise, employer-provided benefits relating to an attendant to assist an employee in the performance of the employee's duties are excluded from income where the employee has a severe and prolonged mental or physical impairment.

Clause 4

Employee Stock Options

ITA
7

Section 7 of the Act provides rules for determining the amount to be included in a taxpayer's employment income in respect of the exercise or sale of rights arising under an employment-related stock option agreement.

Subclause 4(1)

ITA
7(1)

Paragraph 7(1)(a) of the Act treats a taxpayer who acquires shares under an employee stock option agreement as having received, at the time the shares are acquired, a benefit from employment equal to the excess of the fair market value of the shares at that time over the amount paid by the taxpayer for those shares. Paragraphs 7(1)(b) to (d) provide similar rules for determining the amount of the benefit where the employee disposes of, rather than exercises, the option.

Paragraphs 7(1)(a) to (d) are amended, applicable to the 1988 and subsequent taxation years, to clarify that the benefit otherwise determined under these provisions is to be reduced by any amount paid by the employee to acquire the stock option as well as any amount paid for the shares themselves. In order to prevent double taxation in respect of the same amount, paragraphs 7(1)(b), (c) and (d) will not apply to the extent that, as a consequence of the death of an employee, the rules in new paragraph 7(1)(e) have previously applied to include an amount in the income of the deceased.

Paragraphs 7(1)(c) and (d) are also amended to include a benefit in the income of a non-arm's length transferee of an employee stock option if the employee was deceased at the time the shares were acquired. These provisions will apply to non-resident transferees where the employee had performed his duties primarily in Canada.

Subclause 4(2)

ITA
7(1)(e)

New subparagraph 7(1)(e) of the Act, which applies with respect to deaths of taxpayers occurring after July 13, 1990, provides rules that apply on the death of a taxpayer who holds unexercised options under an employee stock option plan.

Paragraph 7(1)(e) treats such an employee as having received an employment benefit in the year in which he dies equal to the difference between the fair market value of the option immediately after the employee's death and the amount paid by the employee to acquire the option.

Subclause 4(3)

ITA
7(1.1)

Subsection 7(1.1) of the Act provides special rules relating to the time at which an employee will be considered to have received a benefit in respect of shares, acquired under an employee stock option plan, of a Canadian-controlled private corporation that is his employer or is related to his employer. The amendment to this subsection, which applies to the 1988 and subsequent taxation years, is strictly consequential to the amendment to paragraph 7(1)(a) and ensures that the terminology used in subsection 7(1.1) corresponds with that contained in new paragraph 7(1)(a).

Subclause 4(4)

ITA
7(1.4) and (1.5)

Under subsection 7(1), an employee who disposes of an employee stock option will generally be treated for income tax purposes as having received a benefit from employment at the time of the disposition. Subsection 7(1.4) of the Act provides an exception to this treatment where the disposition occurs as a result of an amalgamation or merger of corporations and the employee simply exchanges options, receiving no consideration other than options on the shares of the new corporation resulting from the amalgamation or merger.

Subsection 7(1.4) is amended to extend this rollover treatment to any exchange of options where certain conditions are met. New subsection 7(1.4) will apply to any type of corporate reorganization or capital restructuring within a non-arm's length corporate group (provided that the taxpayer receives no consideration on the exchange other than the new option) and will no longer be restricted to exchanges on an amalgamation or merger of corporations. However, new paragraph 7(1.4)(c) will require that the taxpayer not derive an economic gain on the exchange, which is to be determined by comparing the excess of the fair market value of the new shares immediately after the exchange over the new option price against the excess of the fair market value of the old shares immediately before the exchange over the old option price. This amendment is applicable to the 1988 and subsequent taxation years, except where the taxpayer elects not to have the amended provision apply to dispositions occurring before July 14, 1990.

Subsection 7(1.1) of the Act provides that, in the case of shares of the capital stock of a Canadian-controlled private corporation issued under an employee stock option plan, the employment benefit determined under paragraph 7(1)(a) is, under certain conditions, to be included in the employee's income only in the taxation year in which the employee disposes of or exchanges the shares. Subsection 7(1.5) of the Act provides an exception from subsection 7(1.1) for an employee who disposes of such shares in exchange for other shares as part of a share-for-share exchange to which subsection 85.1(1) applies or an amalgamation to which subsection 87(4) applies. For the purposes of subsection 7(1.1) and the two year holding period required to obtain the special deduction under paragraph 110(1)(d.1) of the Act, subsection 7(1.5) treats the taxpayer as not having disposed of the shares under such circumstances.

Subsection 7(1.5) is amended to extend this rollover treatment to any exchange of shares where certain conditions are met. New subsection 7(1.5) will apply to any type of corporate reorganization or capital restructuring within a non-arm's length corporate group (provided that the taxpayer receives no consideration on the exchange other than shares of the corporation, the amalgamated corporation or a corporation with which the corporation or amalgamated corporation does not deal at arm's length) and will no longer be restricted to exchanges under subsection 85.1(1) or amalgamations under subsection 87(4). However, new paragraph 7(1.5)(c) will require, as a condition for the application of this rule, that the total fair market value of the new shares immediately after the exchange not exceed the total fair market value of the old shares immediately before the exchange. This amendment is applicable to the 1988 and subsequent taxation years, except where the taxpayer elects not to have the amended provision apply to dispositions occurring before July 14, 1990.

Subclause 4(5)

ITA
7(6)

Subsection 7(6) of the Act applies where a corporation has entered into an arrangement with a trustee whereby shares of the capital stock of the corporation are held in trust for sale to an employee. Paragraph 7(6)(a) has the effect, for the purposes of section 7, of treating an employee who acquires rights under such an arrangement in the same manner as an employee who acquires such rights directly from the corporation.

Paragraph 7(6)(a) is amended, applicable to the 1988 and subsequent taxation years, to ensure that it also applies for the purposes of the special deduction provided to employees under paragraphs 110(1)(d) and (d.1) of the Act of one-quarter (one-third in 1988 and 1989) of the amount required by subsection 7(1) to be included in the employee's income.

Clause 5

Deductions from Employment Income

ITA
8

Section 8 of the Act provides a deduction in respect of various amounts in computing a taxpayer's income from an office or employment.

Subclause 5(1)

ITA
8(1)(f)

Paragraph 8(1)(f) permits a commissioned salesperson to deduct amounts expended for the purpose of earning income from employment, where the salesperson was not in receipt of a non-taxable travel allowance and was required by the contract of employment to pay his or her expenses and carry on the duties of employment away from the employer's place of business. In order to be deductible, the amounts cannot be in respect of capital expenditures (otherwise than as provided in paragraph 8(1)(j)) or in respect of expenses the deduction of which would be prohibited under paragraph 18(1)(l) if the employee was earning business income rather than employment income.

This amendment clarifies that, in addition to the foregoing restrictions, where an amount paid by the employee results in a reduction of the standby charge that would otherwise be included in computing the employee's income, that amount will not be deductible under paragraph 8(1)(f). This amendment applies to the 1990 and subsequent taxation years.

Subclause 5(2)

ITA
8(1)(h)

Subparagraph 8(1)(h)(iii) permits the deduction of travelling expenses incurred by an employee in the performance of duties of an office or employment, where, among other conditions, the employee is not in receipt of an allowance for travelling expenses that was by reason of subparagraphs 6(1)(b)(v), (vi), (vii) or (vii.1) not required to be included in computing income.
Subparagraph 6(1)(b)(vii.1) refers to an allowance in respect of motor vehicle expenses. As a result, an employee who is in receipt of an allowance in respect of motor vehicle expenses, which is non-taxable by reason of subparagraph 6(1)(b)(vii.1), is prevented from deducting travelling expenses, such as meal and accommodation expenses, in the course of employment, for which the employee may not have been reimbursed or otherwise compensated.

Paragraph 8(1)(h) is amended to permit an employee to deduct travelling expenses, other than motor vehicle expenses, where the taxpayer was not in receipt of an allowance for such expenses which was non-taxable by reason of subparagraphs 6(1)(b)(v),(vi) or (vii) and the taxpayer does not claim any deduction for the year under paragraphs 8(1)(e),(f) or (g).

This amendment is applicable to the 1988 and subsequent taxation years.

Subclause 5(3)

ITA
8(1)(h.1)

New paragraph 8(1)(h.1) provides for the deduction by an employee of motor vehicle expenses where the employee

- was ordinarily required to carry out the duties of employment away from the employer's place of business or in different places,

- was required under the contract of employment to pay motor vehicle expenses incurred in the performance of the employment duties,

- was not in receipt of an allowance in respect of motor vehicle expenses which was, by reason of paragraph 6(b), not required to be included in the taxpayer's income, and

- did not claim a deduction for the year for travelling expenses under paragraph 8(1)(f) of the Act.

This amendment is applicable to the 1988 and subsequent taxation years.

Subclauses 5(4) and (5)

ITA
8(1)(j)

Paragraph 8(1)(j) of the Act is amended consequential upon the introduction of the definitions "automobile" and "motor vehicle" in subsection 248(1), which apply for the purposes of the Act. Paragraph 8(1)(j) refers to an "automobile" and permits the deduction, by an employee, of interest expense and capital cost allowance in respect of an automobile used in the performance of duties of an office or employment. The new definition of automobile excludes certain vehicles such as vans and pick-up trucks, thus inadvertently denying the deduction of interest and capital cost allowance in respect of such vehicles. Accordingly, paragraph 8(1)(j) is amended to refer to a "motor vehicle" rather than an "automobile" in order to reinstate the deductibility of such amounts.

In addition, paragraph 8(1)(j) is amended to provide for the deduction of interest payable in respect of the balance of a debt incurred for the purpose of acquiring a motor vehicle that is used, or an aircraft that is required for use, in the performance of the duties of the taxpayer's office or employment.

Paragraph 8(1)(j) is also amended to refer to new paragraph 8(1)(h.1) which permits the deduction of motor vehicle expenses.

The amendments to paragraph 8(1)(j) are applicable to the 1988 and subsequent taxation years.

Subclause 5(6)

ITA
8(1)(q)

New paragraph 8(1)(q) is applicable to the 1991 and subsequent taxation years and provides for the deduction by an employed artist in respect of actual expenses paid for the purpose of earning employment income from certain artistic activities. In order to qualify for the deduction, the expenses must have been incurred in respect of an activity that is both artistic and is referred to in any of subparagraphs 8(1)(q)(i) to (iv). Therefore, for example, a newspaper article written by a journalist employed by the newspaper or an opinion written by a lawyer employed in a law firm would generally not qualify, since the employee's activities would generally not be considered to be artistic activities. The deduction for qualifying expenses is limited to an amount that is the lesser of $1,000 or 20% of the taxpayer's income as an employee from artistic activity. The maximum amount deductible will be reduced by amounts deductible in calculating employment income from artistic activities under paragraph 8(1)(j), in respect of motor vehicle and aircraft costs, and under paragraph 8(1)(p), in respect of musical instrument costs.

Subclause 5(7)

ITA
8(10)

Subsection 8(10) of the Act provides that expenses will not be deductible by an employee under paragraph 8(1)(f) or (h) or subparagraph 8(1)(i)(ii) or (iii) unless the employee files with the return of income a prescribed form signed by the employer to the effect that the employee met the requirements of the relevant provisions for the deductibility of such expenses. Subsection 8(10) is amended to include a reference to new paragraph 8(1)(h.1) which permits the deduction of motor vehicle expenses. This amendment is applicable to the 1988 and subsequent taxation years to coincide with the coming-into-force of new paragraph 8(1)(h.1).

Subclause 5(8)

ITA
8(12)

Subsection 7(2) of the Act applies for the purposes of section 7 and paragraphs 110(1)(d) and (d.1) of the Act to treat an employee as having acquired a share under a stock option agreement where the share is held in trust for the employee, whether absolutely, conditionally or contingently. When a trust acquires such a share a benefit to the employee may arise under subsection 7(1) and will be included in the employee's income from employment. Occasionally, a stock option agreement will impose conditions that must be satisfied by an employee before title to the share will vest in the employee. Where these conditions are not satisfied, the employee may be entitled only to a return of amounts paid under the agreement, that is, the option price. Under these circumstances, the employee will have been subject to tax under subsection 7(1) without having received any economic benefit under the stock option plan.

New subsection 8(12) of the Act, which applies to the 1988 and subsequent taxation years, is intended to recognize the absence of any net benefit to the employee in such cases. It applies where, as a result of the employee having failed to meet the conditions necessary for him to acquire the share, the trust disposes of the share to the issuing corporation, or the issuing corporation cancels or redeems the share, for an amount that is not greater than that previously paid by the employee for the purpose of acquiring that share. In this case paragraph 8(12)(e) provides a deduction to the employee, for the year in which the share is disposed of, redeemed or cancelled, equal to the amount by which the benefit deemed under subsection 7(1) to have been received by the employee in the year or a preceding year in respect of the share exceeds any deductions claimed by the employee under paragraph 110(1)(d) or (d.1) in respect of the benefit. Since the amount of the benefit included in the employee's income will be offset by the deduction, new paragraph 8(12)(f) effectively treats any gain or loss of the employee from the disposition of the share to be nil. It also excludes the operation of section 84 of the Act in order that no dividend will be deemed to have been received by the employee in respect of the disposition.

ITA
8(13)

New subsection 8(13) of the Act is consequential to the tax reform amendments applicable in respect of home office expenses of self-employed individuals and extends those rules to home office expenses of employees. This provision sets out the conditions that must be met before an amount may be deducted in respect of the "work space" in a self-contained domestic establishment in which the employee resides. The work place must be either the principal place of employment of the employee or used by the employee exclusively for the purpose of earning income from an office or employment and be used on a regular and continuous basis for meeting customers or other persons in the ordinary course of performing the duties of the office or employment. Where these conditions are met, the employee may deduct otherwise allowable amounts, to the extent of the employee's income from the office or employment for the year. To the extent that this latter requirement restricts the deduction of a portion of expenses for a particular year, such expenses are treated as work space expenses incurred in the immediately following year, thus permitting an indefinite carryforward of this type of expense for deduction in computing the employee's income from the same office or employment. This amendment is applicable to the 1991 and subsequent taxation years.

Clause 6

Valuation of Inventory

ITA
10

Section 10 of the Act provides rules concerning the valuation, for the purposes of the Act, of inventory held in a taxpayer's business.

Subclause 6(1)

ITA
10(1.1)

Subsection 10(1.1) of the Act permits a taxpayer to include in the cost of land that is held as inventory, amounts for which a deduction is denied by reason of subsection 18(2) to the taxpayer, to a person with whom the taxpayer does not deal at arm's length, to a specified shareholder of the taxpayer or to a partner whose share of any income or loss of the taxpayer is 10% or more.

This amendment is intended to ensure that an addition to the cost of land inventory may be made in respect of amounts for which a deduction is denied by reason of subsection 18(2) to certain related parties, notwithstanding that those parties will also be entitled to a cost base adjustment in respect of their interest in the taxpayer pursuant to paragraph 53(1)(d.3), where the taxpayer is a corporation, or subparagraph 53(1)(e)(xi), where the taxpayer is a partnership.

Subsection 10(1.1) is further amended to refer to an amount that was "added to", rather than "included in" the cost of any property in order to provide consistency with the preamble to subsection 53(1) of the Act which refers to amounts that are to be added to the cost of property.

These amendments apply to the 1988 and subsequent taxation years.

Subclause 6(2)

ITA
10(2.1)

New subsection 10(2.1) is intended to clarify that taxpayers are required to be consistent in applying whichever acceptable method of valuing their inventory they have chosen for income tax purposes. Subsection 10(2) of the Act requires a taxpayer to value inventory at the commencement of a year at the same amount as it was valued at the end of the immediately preceding year. New subsection 10(2.1), which applies for the purposes of computing income for the 1990 and subsequent taxation years, clarifies that a taxpayer must also value inventory at the end of a year using the same method as the taxpayer used at the end of the preceding year. This subsection does, however, permit a taxpayer to change the valuation method used in respect of a business where that change is approved by the Minister of National Revenue.

Subclauses 6(3) and (4)

ITA
10(6) to (8)

Subsections 10(6) to 10(8) of the Act deal with the valuation of the inventory of an individual's artistic endeavour.

In order to avoid any ambiguity, the expression "entreprise artistique" is substituted for the expression "activité artistique" in the French version of the Act.

Clause 7

Income from Business or Property

ITA
12

Section 12 of the Act requires the inclusion of various amounts in computing a taxpayer's income for a taxation year from a business or property.

Subclause 7(1)

ITA
12(1)(o)

Paragraph 12(1)(o) of the Act generally requires the inclusion in a taxpayer's income for a taxation year of amounts that become receivable in the year by the Crown as a royalty or similar amount reserved by the Crown in relation to the production in Canada of petroleum, natural gas, metals or minerals extracted from property in Canada in which the taxpayer has an interest. Paragraph 12(1)(o) does not apply in respect of amounts paid or payable by the taxpayer for which a deduction is denied in computing income under paragraph 18(1)(m).

Subparagraph 12(1)(o)(v) was amended, with respect to amounts receivable after 1984, to restrict the application of paragraph 12(1)(o) in respect of production from tar sands and iron ore to such royalties in respect of tar sands production to the crude oil stage and iron production to the pellet stage. As a result of this amendment, however, coal royalties were arguably excluded from the scope of the paragraph.

Clause 12(1)(o)(v)(B) is amended with respect to amounts that become receivable after July 13, 1990 to specifically include coal royalties within the scope of paragraph 12(1)(o). A similar amendment to clause 18(1)(m)(v)(B) is also being made.

Subclause 7(2)

ITA
12(9)

Subsection 12(9) of the Act, which provides rules for calculating accrued interest on certain debt obligations, is amended to reinstate a reference to subsection 12(11) in order to ensure that the appropriate amount of interest is calculated for the purposes of the annual accrual rules in respect of investment contracts acquired after 1989.

Subclause 7(3)

"investment contract"

ITA
12(11)(a)

Paragraph 12(11)(a) of the Act defines the term "investment contract" for the purposes of the rules in subsection 12(4) requiring the periodic reporting of accrued investment income. Paragraph 12(11)(a) is amended for the 1985 and subsequent taxation years to ensure that salary deferral arrangements, retirement compensation arrangements, employee benefit plans, and other plans and arrangements excluded from the definitions of "salary deferral arrangement", "retirement compensation arrangement" and "employee benefit plan" are generally not treated as investment contracts. The purpose of this rule is to prevent an overlap of the rules in the Act dealing with such plans and arrangements and the rules in the Act with respect to the accrual of investment income.

This paragraph is also amended for the 1985 and subsequent taxation years to clarify the definition by resolving what would otherwise have been a circularity in the interaction of the definition of "investment contract" (which excludes debt instruments in respect of which the interest is reported at least annually) and subsection 12(4), which requires interest on debt instruments acquired after 1989 to be included in income on an annual accrual basis. A similar circularity was apparent in respect of debt instruments subject to the three-year accrual rules. This amendment is applicable with respect to debt obligations acquired after 1989 and for those acquired before 1990 where the investment income thereon is otherwise included in income at periodic intervals of less than three years.

Paragraph 12(11)(a) is also amended for the 1990 and subsequent taxation years to exclude from the investment income accrual rules those debt obligations held in connection with foreign retirement arrangements. For further detail, see the commentary on the new definition of "foreign retirement arrangement" in subsection 248(1).

Clause 8

Amounts Included in Income

ITA
12.2

Section 12.2 of the Act provides for the inclusion in income of income accrued on certain life insurance policies and annuity contracts.

Subclauses 8(1) and (2)

ITA
12.2(1) and (3)

The amendments to subsections 12.2(1) and (3) of the Act combine, for life insurance policies last acquired after 1989, the new annual reporting provision contained in subsection 12.2(3) of the Act for individual policyholders with the previous annual reporting provision contained in subsection 12.2(1) for corporate policyholders. The change to annual reporting for individual policyholders eliminates the need for the two separate rules for policies last acquired after 1989.

Subclause 8(3)

ITA
12.2(5)

The amendment to subsection 12.2(5) of the Act, which applies to contracts last acquired after 1989, is consequential on the amendment to subsection 12.2(3). The amendment also clarifies that an annuity contract that would be subject to accrual taxation in a year, were it not for the fact that the contract did not have an anniversary day in the year and while held by the taxpayer, will be subject to the provisions of subsection 12.2(5) in that year.

Subclause 8(4)

ITA
12.2(8)

Subsection 12.2(8) of the Act provides that an annuity contract acquired before 1990 will be subject to annual investment income accrual where premiums paid after 1989 were not fixed before 1990. The subsection is amended to confirm that this rule applies to contracts that are subject to triennial reporting under subsection 12.2(3), as it applies in respect of life insurance policies last acquired before 1990, but does not apply to any annuity contract that is already subject to annual investment income accrual as a result of an election for that purpose made under the existing accrual rules. The amendment also allows the portion of a premium paid after 1989 that was fixed before 1990 to be treated in the same way as premiums paid before 1990, while the portion of the premium that was not fixed before 1990 is treated as having been paid to acquire a new annuity contract and will be subject to the annual investment income accrual rule.

Subclause 8(5)

ITA
12.2(11)(b)

The definition of "anniversary day" for life insurance policies and annuity contracts acquired after 1989 in paragraph 12.2(11)(b) is amended to make it consistent with the definition of that term for the purposes of the accrual rules in respect of investment contracts in section 12 of the Act. As a result of this change, the annual reporting requirement for life insurance policies will apply on the basis of a full policy year ending in the policyholder's taxation year, for policies acquired after 1989. For example, where a policy is acquired on July 1, 1990, the growth accrued therein for the first year of the policy will be required to be included in income for the policyholder's taxation year that includes June 30, 1991, unless the policy is disposed of at an earlier date. The new annual reporting rule is also amended to clarify that the rule will apply in respect of life insurance policies last acquired after 1989.

Clause 9

Depreciable Property

ITA
13

Section 13 of the Act contains rules governing the treatment of depreciable property for the purposes of sections 13 and 20 and the capital cost allowance regulations.

Subclause 9(1)

ITA
13(4.1)

Subsection 13(4.1) of the Act describes the conditions under which a depreciable property acquired by a taxpayer will be a "replacement property" for the purposes of subsection 13(4). The replacement property rules under subsection 13(4) of the Act allow a taxpayer to defer recognition of recaptured depreciation in respect of the disposition of a depreciable property if that property is replaced by a similar property within a specified time period.

Paragraph 13(4.1)(a) of the Act is amended to extend the replacement property rules relating to depreciable properties, where the former property was used for the purpose of producing business or property income, to circumstances where the use for which the replacement property was acquired is the same as or similar to the use made of the former property by a person related to the taxpayer.

Paragraph 13(4.1)(b) of the Act is amended to extend the replacement property rules relating to depreciable properties, where the former property was used for the purposes of producing business income, to circumstances where the similar use for which the replacement property is used is carried on by a related person.

Paragraph 13(4.1)(c) of the Act is, generally, amended to restrict the benefit of the replacement property rules applicable with respect to depreciable property to replacement properties that meet the definition of "taxable Canadian property" in paragraph 115(1)(b) of the Act. This restriction will, however, be limited to circumstances where the former property was taxable Canadian property or would have been taxable Canadian property if the taxpayer were non-resident throughout the year in which the former property were used in business carried on by the taxpayer.

The amendments to paragraphs 13(4.1)(a) and (b) are applicable with respect to dispositions of former properties occurring after July 13, 1990.

The amendment to paragraph 13(4.1)(c) is generally applicable to replacement properties for former properties disposed of after April 2, 1990.

Subclause 9(2)

ITA
13(6)

Subsection 13(6) of the Act sets out the rules for misclassified depreciable property. It provides that, where an amount in respect of depreciable property of a prescribed class has in any year been added to the capital cost of depreciable property of another class, the Minister may treat the property as having been properly included as property of the other class prior to the commencement of a preceding taxation year and to have been transferred to the correct class at the commencement of that preceding year. The Minister may do so with respect to any of the taxation years for which he may make an assessment or reassessment under subsection 152(4) of the Act. Subsection 13(6) is amended as a consequence of the introduction of paragraph 152(4)(c) to refer to all of subsection 152(4) rather than only paragraphs (a) and (b) thereof.

This amendment is applicable after April 19, 1983, the date as of which paragraph 152(4)(c) was introduced.

Subclauses 9(3) and (5)

ITA
13(7)(a), (b) and (d)

Subsection 13(7) of the Act provides special rules relating to depreciable property, including those that apply in determining the capital cost and proceeds of disposition of depreciable property on its change, or partial change, in use.

Paragraph 13(7)(a) provides that, where a taxpayer acquires property for the purpose of gaining or producing income and subsequently uses the property for a purpose other than gaining or producing income, the taxpayer is considered at the time of the change in use to have disposed of the property for proceeds equal to its fair market value at that time. New paragraph 13(7)(a) provides that the taxpayer will also be treated as having reacquired the property immediately thereafter at a cost equal to that fair market value.

Paragraph 13(7)(b) determines the capital cost to a taxpayer of depreciable property acquired for a purpose other than gaining or producing income, where the taxpayer commences to use the property for the purpose of gaining or producing income. Paragraph (b) is amended to ensure that, in determining the capital cost of the property, the cost included under clause 13(7)(b)(ii)(B) is the original cost of the property to the taxpayer.

Subparagraph 13(7)(d)(i) determines the capital cost of depreciable property where the use of the property for the purpose of gaining or producing income increases relative to other uses made of the property. Clause 13(7)(d)(i)(B) provides that, on such a change in use, the capital cost of the property will be increased by a portion of the excess of the proceeds of disposition of the property, as determined under subparagraph 45(1)(c)(ii) of the Act, over the capital cost of the property (to the extent that no capital gains exemption was claimed in respect of that excess). The amendment to clause 13(7)(d)(i)(B) provides that it is only that proportion of the original capital cost of the property that the percentage increase in income-producing use is of the whole use of the property that is to be included in determining that excess.

The amendments to paragraphs 13(7)(a), (b) and (d) of the Act apply to changes in use occurring after May 22, 1985, subject to a transitional provision which reflects the changes in the capital gains inclusion rate after that date.

Subclause 9(4)

ITA
13(7)(c)

Paragraph 13(7)(c) of the Act deals with the calculation of the cost, for capital cost allowance purposes and the calculation of proceeds of disposition, of property used regularly by a taxpayer in part for the purpose of earning income and in part for some other purposes. This paragraph does not apply to a motor vehicle which is subject to the restrictions on the deductibility of certain expenses and capital cost allowance.

Paragraph 13(7)(c) is amended by deleting the reference to a motor vehicle in respect of which section 67.3 applies, as a consequence of an amendment to that section introduced on second reading of Bill C-139 (1988). This amendment is applicable with respect to changes in use occurring after April 1988.

Subclause 9(6)

ITA
13(7)(e)

Paragraph 13(7)(e) of the Act contains special rules which apply on the direct or indirect transfer of depreciable property between persons who do not deal at arm's length. Such parties are referred to herein as the "transferor" and the "transferee". The rules are intended to prevent taxpayers from increasing the depreciable base of property through the use of a non-arm's length transfer of depreciable property in respect of which the transferor benefits from the exclusion of 1/4 of capital gains from income and the capital gains exemption provided under section 110.6.

Paragraph 13(7)(e) provides two general rules for the purposes of the provisions relating to capital cost allowance. First, where the cost of depreciable property to the transferee would otherwise exceed the capital cost of the property to the transferor, subparagraphs 13(7)(e)(i) and (ii) generally provide that the capital cost of the property to the transferee is limited to the sum of the capital cost of the property to the transferor and the transferor's taxable capital gain in respect of the property minus any related claim by the transferor for a capital gains exemption under section 110.6. Second, in the event that the capital cost of depreciable property to the transferor would otherwise exceed the capital cost of the property to the transferee, subparagraph 13(7)(e)(iii) provides that the property is treated as having been acquired by the transferee at the transferor's capital cost and that such excess is considered to have been capital cost allowance claimed by the transferee in respect of the property. This ensures that depreciation recapture will not be avoided if the property is later disposed of for an amount in excess of the transferee's capital cost, determined without reference to subparagraph 13(7)(e)(iii). (These rules also apply in a similar fashion where the transferor transfers capital property that is depreciable property to the transferee but not to the transferor.)

Paragraph 13(7)(e) is amended so that the rules therein do not apply to the direct or indirect transfer of depreciable property as a consequence of the death of an individual. This avoids the application of those rules to the acquisition of property by a testamentary trust on the death of an individual or to the acquisition of such property by a beneficiary under such a trust.

Paragraph 13(7)(e) is also amended so that the rules therein do not apply to timber resource property. This amendment and a parallel amendment to paragraph 13(7)(f) are appropriate because the gain on a timber resource property is fully included in income and is not treated as a capital gain.

The amendments to this paragraph are applicable with respect to property acquired after May 22, 1985.

Subclause 9(7)

ITA
13(7)(f)

Paragraph 13(7)(f) of the Act applies where a corporation is treated by either paragraph 111(4)(e) (change of control) or paragraph 149(10)(b) (change of taxable status) as having disposed of and reacquired its depreciable property. In these circumstances, the capital cost to the corporation, for capital cost allowance purposes after the reacquisition, is limited to the capital cost to the corporation at the time of disposition plus 3/4 of the excess of the proceeds of disposition over the capital cost to the corporation at the time of disposition. This rule is similar to the rules in subparagraphs 13(7)(e)(i) and (ii) in that it prevents an increase in the depreciable base of capital property, to the extent that such increase relates to a non-taxed portion of a capital gain.

Paragraph 13(7)(f) is amended so that it does not apply to timber resource property the gain on which is fully taxable. This is related to the parallel amendment made to paragraph 13(7)(e) and discussed above.

This amendment is applicable with respect to property acquired after May 22, 1985.

Subclause 9(8)

ITA
13(7)(h)

Paragraph 13(7)(h) of the Act prevents the $20,000 limit on the depreciable capital cost of a passenger vehicle from being circumvented by a transfer of the vehicle between parties not dealing at arm's length. Where a passenger vehicle is acquired by a taxpayer from a person with whom the taxpayer was not dealing at arm's length, the capital cost to the taxpayer of the vehicle at that time is treated as the least of $20,000 (or such other amount as may be prescribed), its fair market value and its undepreciable capital cost to the transferor immediately before the transfer.

This amendment, which applies with respect to property acquired after May 22, 1985, clarifies that paragraph 13(7)(h) will govern in situations where a passenger vehicle is being transferred between non-arm's length parties, notwithstanding the general rule contained in paragraph 13(7)(g). This latter rule imposes a limit on the depreciable capital cost of a passenger vehicle whose actual cost exceeds $20,000 or such other amount as may be prescribed.

Subclause 9(9)

ITA
13(21)(a)

The definition "conversion" with respect to vessels, in paragraph 13(21)(a) of the Act, is amended to delete the requirement for the approval of conversion plans and the determination of "conversion costs" by the Minister of Regional Industrial Expansion. Similar amendments, effective for property acquired after July 13, 1990, will be proposed to subparagraph 1100(1)(v)(i) and subsection 1101(2a) of the Income Tax Regulations in order to eliminate the requirement for certification of all vessels and conversion costs by the Minister of Regional Industrial Expansion. These provisions, which are relevant for the purposes of the accelerated capital cost allowance provisions in respect of certified Canadian vessels, will, in the future, be verified by Revenue Canada as part of the normal audit process.

The amendment to paragraph 13(21)(a) of the Act applies to conversions commencing after July 13, 1990.

ITA
13(21)(b)

Paragraph 13(21)(b) of the Act, which defines "depreciable property", is amended to clarify that a property may be depreciable property even though it is not yet considered to be available for use within the meaning of subsection 13(26) of the Act. Subject to the application of subsection 13(26) of the Act in respect of capital cost allowance claims, such property of the taxpayer will nevertheless be added to the undepreciated capital cost of the particular Class of property pursuant to subparagraph 13(21)(f)(i) of the Act.

This amendment is applicable with respect to property acquired after 1989.

Subclause 9(10)

ITA
13(21)(e)

"total depreciation"

Paragraph 13(21)(e) of the Act defines "total depreciation", for the purposes of the provisions of the Act and the Regulations governing recapture of depreciation, terminal losses and capital cost allowance, as the aggregate of amounts allowed in respect of capital cost allowance and terminal losses. This paragraph is amended by deleting the reference to amounts that would have been deducted in respect of capital cost allowance but for section 67.3, as a consequence of an amendment to that section introduced on second reading of Bill C-139 (1988).

This amendment is applicable to taxation years and fiscal periods commencing after June 17, 1987 that end after 1987. "Total depreciation" now is defined as the aggregate of amounts deducted in respect of capital cost allowance and amounts deducted under subsection 20(16) in respect of terminal losses or that would have been so deducted but for subsection 20(16.1).

Subclause 9(11)

ITA
13(26) to (32)

New subsections 13(26) to (32) of the Act (in conjunction with new subsections 37(1.2) and 127(11.2)) implement the 1987 tax reform proposals to postpone any claim in respect of capital cost allowance, investment tax credits and certain expenditures on scientific research and experimental development until the time at which the associated property is available for use by the taxpayer for the purpose of earning income from a business or property. These new subsections are generally applicable with respect to property acquired after 1989.

ITA
13(26)

New subsection 13(26) of the Act provides that, for the purpose only of calculating the capital cost allowance claim to which a taxpayer may be entitled, no amount in respect of a property is to be included in computing the undepreciated capital cost of depreciable property of a prescribed class until the property has become "available for use" by the taxpayer. The rules for determining the time at which property becomes "available for use" are provided in new subsections 13(27) to (32), described below.

ITA
13(27)

New subsection 13(27) of the Act, in conjunction with the provisions of new subsections 13(29) to (32), establishes the time at which property (other than a building) is considered to have become available for use by a taxpayer for the purposes of determining, under new subsection 13(26), the time at which capital cost allowance may first be claimed. The available-for-use rules are also relevant for the purposes of new subsections 37(1.2) and 127(11.2) of the Act, which govern the time at which certain deductions in respect of research and experimental development expenses of a capital nature and investment tax credits may commence to be claimed.

Paragraphs 13(27)(a) to (k) provide that a property (other than a building) acquired by a taxpayer will be considered to be available for use at the earliest of the following times:

- the time at which the property is first used for the purpose of earning income,
- the beginning of the first taxation year commencing at least 358 days after the taxation year in which the property was acquired (the two-year "rolling start" rule),
- the time immediately before the property is disposed of by the taxpayer (it should be noted that this time is deemed not to be relevant for the purposes of new subsection 127(11.2)),
- the time the property has been delivered (or where of a type not generally considered to be deliverable - for example, self-constructed property - has been made available to the taxpayer) and is, either alone or in combination with other property in the possession of the taxpayer at that time, capable of producing a saleable product or performing a saleable service,
- in the case of air or water pollution-abatement equipment, the time at which the property is installed and capable of operating,

- in the case of certain public corporations and their subsidiaries, the end of the year in which the property (or part thereof) commences to be depreciated for accounting purposes,

- in the case of property acquired for use in a farming or fishing business, the time at which the property is delivered and is capable of operating,

- in the case of certain transportation equipment in respect of which various operational permits, licences or certificates may be required, the time at which those permits, licences and certificates have been acquired,

- in the case of spare parts that are capital property, the time at which the property for which the spare part may be required is available for use,

- in the case of certain offshore oil production facilities, the time at which the concrete gravity base structure deballasts and lifts the topside facilities, and

- in the case of a property that is a replacement property for another property involuntarily disposed of that was acquired before 1990 or that had become available for use, the time the replacement property is acquired.

ITA
13(28)

New subsection 13(28) of the Act establishes the time at which a building is considered to be available for use by a taxpayer for the purpose of new subsection 13(26). Subsection 13(28) provides that a building or part thereof will be considered to have become available for use at the earliest of the following times:

- the time at which the taxpayer begins to use all or substantially all of the building for its intended purpose,

- the time at which the construction of the building is complete,

- the beginning of the first taxation year commencing at least 358 days after the end of the year in which the taxpayer acquired the property,

- the time immediately before the property is disposed of by the taxpayer (under new subsection 127(11.2), this time is not considered for the purposes of determining when an investment tax credit may be claimed), and

- in the case of a building that is a replacement property for another building involuntary disposed of that was acquired before 1990 or that had become available for use, the time the replacement building is acquired.

A renovation, alteration or addition to a building will be considered to be a separate building for the purposes of new subsection 13(28).

ITA
13(29)

New subsection 13(29) of the Act provides an election in respect of property, including buildings other than rental buildings, acquired for use in a long-term project. Where such an election is made by the taxpayer, the general available-for-use rules will be applied to all project-related expenditures made in the year in which project property was first acquired after 1989 and in the following year. However, in the third and subsequent years, application of the available-for-use rules to expenditures made as part of the project will be limited so that only those expenditures in any such year in excess of certain threshold amounts will be subject to the rules. These threshold amounts are determined with reference to expenditures incurred, on property that is part of the project, after 1989 and during years ending after the project commenced and at least 358 days before the beginning of the year under consideration. For example, in the case of a long-term project commencing after 1989, the amount of expenditures excepted from the available-for-use rules in the third year of the project under this special provision would be limited by the amount of project expenditures incurred in the first year of the project. The amount of expenditures excepted from the rules in the fourth year of the project would be limited, in general terms, by the amount of such expenditures on property in the second year of the project plus the amount of such expenditures from the first year that were not used in the third year to exclude expenditures. Those expenditures excepted from the application of the available-for-use rules through this mechanism will be subject to the half-year convention.

It should be noted that the capital cost of properties that become available for use under the general available-for-use rule (except by reason of the two-year rolling start rule) will not be taken into account in computing the threshold amounts from earlier years of a project. This restriction reflects the policy underlying this provision as an alternative to the other special relieving provisions. Projects that commence before 1990 but end after 1989 are, for the purposes of the rule, effectively treated as if the expenditures made after 1989 relate to a separate project that commenced at the beginning of 1990.

The following examples illustrate the application of an election to use the long-term project rule provided under subsection 13(29).

Example A

A $160 million industrial project commences in year 1 and is completed and put in use to earn income in year 6. It is assumed that none of the property incorporated in the project will be otherwise available for use until the project is completed (other than property which becomes available for use during the construction period by reason of this rule or by reason of the two-year rolling start rule). The taxpayer elects in year 3 of the project to have the long-term project rule apply. The application of subsection 13(29) in these circumstances is shown below.

Year	Expenditures	Additions to U.C.C.			Current Year Expenditures
		Long-term Project	Rolling Start	Other	Deferred
1	10	0	n/a		10
2	20	0	n/a		20
3	70	10(1)	10(2)		60
4	50	20(3)	20(4)		30
5	5	35(5)	60(6)		0
6	5	0		5(7)	0
TOTAL	160	65	90	5	

(1) lesser of 70 (year 3 expenditures not available for use before the end of that year)
and 10-0=10 (year 1 expenditures less amounts previously determined to be available for use under this rule)
=10

(2) year 1 expenditures available for use under the rolling start rule (not subject to the half-year convention)

(3) lesser of 120-10=110 (year 3 and 4 expenditures not available for use before the end of the year)
and 30-10=20 (aggregate of year 1 and 2 expenditures less amount calculated under (1), above)
=20

(4) year 2 expenditures available for use under the rolling start rule (not subject to the half-year convention)

(5) lesser of 125 (aggregate of year 3, 4 and 5 expenditures) less 10+20+60 (portion of year 3, 4, and 5 expenditures already available for use at the end of the year)
= 35 (year 3, 4, and 5 expenditures not available for use before the end of the year)

and 100 (aggregate of year 1, 2 and 3 expenditures) less 30 (aggregate of amounts calculated under (1) and (3), above) = 70

=35

(6) remainder of year 3 expenditures available for use under the rolling start rule

(7) year 6 expenditures available for use when the project is put in use (paragraph 13(27)(a) of the Act) during the sixth year.

Example B

Another long-term project has a different expenditure pattern. It is assumed that one-half of the property acquired in year 2 of the project becomes available for use during year 3 pursuant to paragraph 13(27)(d) (the intermediate-product rule). None of the other property included in the project will be available for use until the project is put in use in the fifth year (other than property which becomes available for use under this rule or the two-year rolling start rule). This taxpayer also elects in year 3 to have the long-term project rule apply. The application of the rules in subsection 13(29) in these circumstances is shown below.

Year	Expenditures	Additions to U.C.C.			Current Year Expenditures
		Long-term Project	Rolling Start	Other	Deferred
1	25	0	n/a	0	25
2	30	0	n/a	0	30
3	20	20(1)	25(2)	15(3)	0
4	40	20(4)	15(5)	0	20
5	10	0	0	30	0
Total	125	40	40	45	

(1) lesser of 20 (year 3 expenditures not available for use before the end of the year)
and 25-0=25 (year 1 expenditures less amounts previously determined to be available for use under this rule)
=20 (subject to the half-year convention)

(2) year 1 expenditures available for use under the rolling start rule, not subject to the half-year convention

(3) portion of year 2 expenditures available for use during year 3 under the intermediate product rule (subject to the half-year convention)

(4) lesser of 60-20=40 (year 3 and 4 expenditures not available for use before the end of the year)
and (55-15)-20=20 (aggregate of year 1 and 2 expenditures less year 1 or 2 expenditures already available for use, determined

without regard to the rolling start rule, less
amount calculated under (1), above)
=20 (subject to the half-year convention)

(5) portion of year 2 expenditures not already available for use that become available for use under the rolling start rule, not subject to the half-year convention

(6) year 5 expenditures and remainder of year 4 expenditures available for use when the project is put in use (paragraph 13(27)(a) of the Act) during the fifth year, subject to the half-year convention

ITA
13(30)

New subsection 13(30) of the Act provides that a property which has become available for use by a taxpayer (other than as a result of a disposition) will also be treated, for the purposes of subsection 13(26), as being available for use by another taxpayer who acquired the property in a non-arm's length transaction or as a consequence of certain divisive reorganizations.

ITA
13(31)

New subsection 13(31) of the Act provides that property acquired by a taxpayer in a non-arm's length transfer or as a consequence of certain divisive reorganizations is to be treated, for the purposes of the rolling-start rule described in the commentary regarding paragraphs 13(27)(b) and (28)(c) and the long-term project rule described in the commentary regarding subsection 13(29), to have been acquired by the taxpayer at the time it was acquired by the transferor.

ITA
13(32)

New subsection 13(32) of the Act provides an anti-avoidance rule intended to offset the benefit that a taxpayer may achieve from accelerating, through a lease of property to a non-arm's-length person, the time at which the property may be considered to have become available for use. In such circumstances, the rent paid by the non-arm's length person (net of rent received by that person for the property) will not be deductible as ordinary rent but, rather, will be depreciable under Class 13 of Schedule II to the Regulations as a cost of acquiring a leasehold interest. As a consequence, the lessee may claim capital cost allowance in respect of those additions to Class 13 only after the property becomes available for use by the lessee, and then only to the extent permitted by the class (which generally prorates such claims over the term of the lease).

Clause 10

Eligible Capital Property

ITA
14

Section 14 of the Act provides rules concerning the tax treatment of expenditures and receipts of a taxpayer in respect of eligible capital properties and operates on a "pooling" basis. Annual deductions, which are calculated as a percentage of this pool, may be claimed under paragraph 20(1)(b) of the Act.

Subclause 10(1)

ITA
14(1)

Subsection 14(1) of the Act provides that where, at the end of a taxation year, the amounts required to be deducted in computing a taxpayer's cumulative eligible capital exceed the amounts required to be added thereto, that excess (for the purposes of this commentary referred to as the "negative balance") must be included in the taxpayer's income for the year as business income or as a taxable capital gain.

Subparagraph 14(1)(a)(iv) provides that, in the case of a taxpayer who is an individual (other than a trust), the amount that must be included in the taxpayer's income is the portion of that negative balance that represents the recapture of previous deductions taken under paragraph 20(1)(b) of the Act in respect of eligible capital property. Subparagraph 14(1)(a)(v) provides that, for such a taxpayer, the remainder of the negative balance is deemed to be a taxable capital gain of the taxpayer from a disposition of capital property by him in the year and is, therefore, eligible for the lifetime capital gains exemption.

The amendment to subparagraph 14(1)(a)(v) excludes from the taxable capital gain an amount equal to one-half of the deductions claimed under paragraph 20(1)(b) before the taxpayer's adjustment time and is intended to avoid an overstatement of the deemed taxable capital gain arising in respect of the disposition of eligible capital property. A taxpayer's adjustment time is defined in paragraph 14(5)(c) to be the time at which the taxpayer's cumulative eligible capital was increased by one-half and all deductions and inclusions in respect of such property became based on three-quarters of the amount of expenditures and receipts made for and derived from eligible capital property. For most taxpayers this time is in 1988.

The amendment to subparagraph 14(1)(a)(v) applies to fiscal periods of individuals commencing after 1987.

Paragraph 14(1)(b) provides that, in the case of any taxpayer to which paragraph 14(1)(a) does not apply, the negative balance must be included in the taxpayer's income.

The amendment to paragraph 14(1)(b) excludes from the amount to be included in income an amount equal to one half of the deductions claimed under paragraph 20(1)(b) before the taxpayer's adjustment time and is intended to avoid an overstatement of the amount to be included in income arising in respect of the disposition of eligible capital property.

The amendment to paragraph 14(1)(b) applies for taxation years of corporations commencing after June, 1988.

Subclause 10(2)

ITA
14(3)

Subsection 14(3) of the Act applies where a taxpayer makes an eligible capital expenditure in respect of the acquisition of an eligible capital property from a non-arm's length vendor. Where the vendor has claimed a capital gains exemption under section 110.6 of the Act in respect of that disposition, the eligible capital expenditure made by the purchaser is reduced in order to deny any deduction under paragraph 20(1)(b) to the purchaser in respect of amounts paid to the non-arm's length vendor which qualified for the lifetime capital gains exemption.

As the Act is currently structured, the amount of the purchaser's cumulative eligible capital is reduced not only for the purposes of the annual deduction under paragraph 20(1)(b) of the Act, but also for the purpose of calculating any gain or recapture arising on the disposition of an eligible capital property. This result is inappropriate where the eligible capital property is disposed of in an arm's length transaction for proceeds exceeding its actual cost as it could potentially cause the same gain to be recognized twice for tax purposes.

Subsection 14(3) is, therefore, amended to provide that the deemed reduction of a taxpayer's eligible capital expenditure in respect of an eligible capital property will not apply in cases where the property was acquired by the taxpayer as a consequence of the death of the transferor and is, in other cases, reversed to the extent that the taxpayer has received proceeds of disposition for the property in excess of that deemed eligible capital expenditure in a subsequent arm's length transaction. This amendment applies with respect to acquisitions of property occurring after 1987.

Subclause 10(3)

ITA
14(5)(a)

Subsection 14(5) of the Act defines certain terms for the purposes of section 14. Paragraph 14(5)(a) defines a taxpayer's cumulative eligible capital. New subparagraph 14(5)(a)(iii.2) is introduced as a consequence of the amendments to subparagraph 14(1)(a)(v) and paragraph 14(1)(b) and prevents the incurring of, or an overstatement of, a negative balance of the taxpayer's cumulative eligible capital in circumstances where an eligible capital property which was acquired before the taxpayer's adjustment time is disposed of after that time.

Subclause 10(4)

ITA
14(7)

Subsection 14(7) of the Act describes the conditions under which an eligible capital property acquired by a taxpayer will constitute a "replacement property" for the purposes of subsection 14(6). The replacement property rules under subsection 14(6) of the Act allow a taxpayer to defer recognition of recaptured deductions in respect of the disposition of an eligible capital property when the property is replaced by a similar property within a specified time period. Paragraph 14(7)(c) of the Act is generally amended to restrict the replacement property rules applicable with respect to eligible capital property to replacement properties used in a business in Canada. The application of this restriction is, however, limited to circumstances where the former property was used by the taxpayer in a business carried on in Canada.

This amendment parallels the corresponding changes to the replacement property rules for depreciable property in subsection 13(4.1) and is generally applicable to replacement properties for former properties disposed of after April 2, 1990.

Clause 11

Shareholder Benefits

ITA
15

Section 15 of the Act requires the inclusion in income of benefits received or enjoyed by shareholders of a corporation.

Subclause 11(1)

ITA
15(1)(b)

Subsection 15(1) of the Act provides that certain benefits conferred on a shareholder by a corporation are included in the shareholder's income. Paragraph 15(1)(b) makes an exception for the payment of a dividend. As a result of the change to the definition of "dividend" in subsection 248(1) of the Act, however, certain stock dividends are deemed not to be dividends. This amendment to paragraph 15(1)(b) ensures that stock dividends paid after June 1988 will not be included in the income of the recipient shareholder by reason of subsection 15(1).

Subclauses 11(2) and (3)

ITA
15(2)

Subsection 15(2) of the Act requires certain shareholder loans to be included in the shareholder's income. Subparagraph 15(2)(a)(ii), which provides an exception to this rule in respect of loans made to enable an employee or the employee's spouse, to acquire a home, is amended to extend this exception to loans made to enable an employee or the employee's spouse to acquire a share of a co-operative housing corporation for the purpose of inhabiting a dwelling unit. This amendment applies to the 1985 and subsequent taxation years.

Subsection 15(2) is also amended to exclude from its application a loan made to an employee of a particular corporation by a corporation related to the particular corporation, where the loan is made to enable the employee to buy treasury shares of the particular corporation or a related corporation. This amendment applies to loans made and indebtedness arising after 1989 and, where a reassessment of the taxpayer's income has not become statute-barred, to loans and indebtedness made or arising after 1981.

Clause 12

Leasing Properties

ITA
16.1

Section 16.1 of the Act provides special rules which may apply in computing the income of a lessee of property, other than prescribed property, leased for a term of more than one year from an arm's length person who is resident in Canada or who carries on business through a permanent establishment in Canada. These rules allow a lessee of property to elect to be treated for income tax purposes as having acquired the leased property at its fair market value and as having financed the purchase through a loan at a prescribed rate of interest.

Subclauses 12(1) and (2)

ITA
16.1(1)

Subsection 16.1(1) is amended to clarify the reference in the leasing rules to the time at which the lease is entered into. It is also amended to ensure that that portion of each lease payment that does not relate to the use of, or the right to use, the property (such as, for example, a payment by the lessee for provincial sales tax) retains its character for income tax purposes and is not recharacterized as a loan payment.

The election by a lessee to be treated as having acquired the property is available where the lessor is non-resident only if the non-resident lessor carries on business in Canada through a permanent establishment. The amendments add an additional requirement that the non-resident lessor's income from that business must be taxable in Canada. This additional requirement does not apply if the lease was entered into before July 13, 1990.

The prescribed rate of interest that is applicable for the purposes of the leasing rules was stated to be the prescribed rate in effect at the time the lease was entered into. In certain circumstances, however, an agreement to lease property may be entered into some time before the commencement of the lease. An amendment to subsection 16.1(1) provides that the rate of interest is that prescribed at the earlier of the time the agreement to enter into the lease is made and the time of the commencement of the lease. It also clarifies that the rate of interest in effect in respect of floating rate leases will be the prescribed rate in effect at the beginning of the period for which the interest is being calculated.

Subclause 12(3)

ITA
16.1(2)(b)

Paragraph 16.1(2)(b) of the Act provides rules which apply where a lessee who has made the joint election referred to in subsection (1) with the owner of the leased property assigns the lessee's interest in the property or subleases the property to another taxpayer with whom the lessee deals at arm's length. That paragraph is amended to provide that, where such a lessee and assignee or sublessee of the property have jointly elected, the assignee or sublessee and the owner will be treated as having filed the joint election referred to in subsection 16.1(1) with their returns of income.

Subclause 12(4)

ITA
16.1(5) to (7)

New subsection 16.1(5) of the Act is added to provide that a lessee of property who has made an election in respect of that property under subsection 16.1(1) will be unaffected by the replacement of that property with another similar property of the lessor unless the amount payable by the lessee as rent is changed. (If the rent payable for the replacement property is greater than or less than the rent payable for the original property, under subsection 16.1(7) the original lease will be treated as having been cancelled and a new lease entered into at that time.)

New subsection 16.1(6) of the Act provides rules which apply when an addition or alteration is made to property in respect of which a lessee has made an election under subsection 16.1(1), and the rent payable by the lessee of the property is increased. In such circumstances, the lessee will be deemed to have acquired the additional property at its fair market value and to have increased the outstanding principal amount of the earlier deemed loan by the fair market value of the additional property.

New subsection 16.1(7) of the Act provides that the renegotiation of a lease that changes the rent payable in respect of the leased property will be treated as the cancellation of the original lease and the entering into of a new lease for the purposes of the rules set out in subsection 16.1(1) of the Act.

New subsections 16.1(5) to (7) are generally applicable to leases and subleases entered into after 10 p.m. E.D.T. April 26, 1989.

Clause 13

Prohibited Deductions - Business and Property Income

ITA
18

Section 18 of the Act prohibits the deduction of certain outlays and expenses in computing a taxpayer's income from a business or property.

Subclause 13(1)

ITA
18(1)(m)

Paragraph 18(1)(m) of the Act prevents a taxpayer from deducting amounts in computing income that are paid or payable by the taxpayer in the year as a Crown royalty or similar amount in relation to the production in Canada of petroleum, natural gas, metals or minerals. Subparagraph 18(1)(m)(v) was amended, with respect to amounts payable after 1984, to restrict the application of paragraph 18(1)(m) in respect of production from tar sands and iron ore to such royalties in respect of tar sands production to the crude oil stage and iron production to the pellet stage. As a result of this amendment, however, coal royalties were arguably excluded from the scope of the paragraph.

Clause 18(1)(m)(v)(B) is amended, with respect to amounts that become payable after June 13, 1990 to specifically include coal royalties within the scope of paragraph 18(1)(m). A similar amendment to clause 12(1)(o)(v)(B) is also being made.

Subclause 13(2)

ITA
18(1)(o.1)

Paragraph 18(1)(o.1) of the Act provides that an outlay or expense made or incurred under a salary deferral arrangement (SDA) in respect of another person is generally not deductible except as permitted by paragraph 20(1)(oo) of the Act. Paragraph 20(1)(oo) allows an employer a deduction in respect of deferred amounts under an SDA which have been included in its employees' income under paragraph 6(1)(a) by virtue of the application of subsection 6(11). There is, however, no deduction provided for an employer in respect of amounts included in an employee's income under paragraph 6(1)(i) -- that is, for amounts actually paid out of an SDA to an employee in excess of amounts previously included in the employee's incomes.

Paragraph 18(1)(o.1) is amended to allow for a deduction under new paragraph 20(1)(pp) of payments under an SDA which have been included in income of another person under paragraph 6(1)(i). Paragraph 20(1)(pp) does not apply in the case of an SDA established primarily for the benefit of one or more non-resident employees in respect of services to be rendered outside Canada, since such an SDA is not affected by paragraph 18(1)(o.1).

These amendments apply to the 1986 and subsequent taxation years.

Subclause 13(3)

ITA
18(1)(s)

Paragraph 18(1)(s) of the Act denies an inventory write-down in respect of loans or lending assets of an insurer, or a taxpayer whose ordinary business includes the lending of money, where the loan or lending asset was acquired in the ordinary course of that insurance or lending business. Such a loan or lending asset may, however, be eligible for a doubtful debt reserve under subparagraph 20(1)(l)(ii). The amendment to paragraph 18(1)(s), which applies to taxation years and fiscal periods commencing after June 17, 1987 that end after 1987, provides that the paragraph also applies to loans or lending assets made in the ordinary course of that business.

Subclause 13(4)

ITA
18(3.1)(a)

Subsection 18(3.1) of the Act denies the immediate deduction of certain costs, generally referred to as construction period soft-costs, relating to the construction, renovation or alteration of a building. These costs are required to be added to the capital cost of the building to which they relate and may be deducted at the rate allowed in respect of the class of depreciable property in which the building is included. Paragraph 18(3.1)(a) is amended, applicable with respect to outlays and expenses made or incurred after 1989, to exclude from the application of this rule certain construction period costs to the extent that those costs are deductible, pursuant to new subsection 20(29), against any rental income from the building.

Paragraph 18(3.1)(a) is also amended to include a reference to new paragraph 20(1)(gg), under which reasonable outlays and expenses made or incurred after 1990 relating to certain disability-related modifications to a taxpayer's building may be deducted in computing the taxpayer's income from a business or property.

Subsection 18(3.1) is also amended to allow a taxpayer who owns land to continue to deduct costs such as interest and property taxes incurred with respect to that land in cases where an arm's length person constructs, renovates or alters a building on that land on that other person's own behalf. This latter amendment is generally applicable to the 1987 and subsequent taxation years.

Subclause 13(5)

ITA
18(3.5)

Subsection 18(3.5) of the Act provides transitional relief from the application of subsection 18(3.1) in respect of projects that had commenced before November 13, 1981. Amendments to subsection 18(3.1) of the Act, which were applicable after May 9, 1985, renumbered certain provisions of that subsection. Subsection 18(3.5) is amended to ensure that the references therein to various provisions of subsection 18(3.1) correspond with the amended version of that subsection. This amendment applies with respect to outlays and expenses made or incurred after May 9, 1985.

Subclause 13(6)

ITA
18(9.1)

New subsection 18(9.1) provides that each portion of a fee paid, in the course of carrying on a business or earning income from property, to reduce the interest rate on a borrowing or on an unpaid purchase price for property shall, to the extent that it relates to and does not exceed the value, at the time that such fee is paid, of a payment of interest that would have been paid by the taxpayer in a future taxation year on such debt, be treated as an interest expense for such future taxation year.

New subsection 18(9.1) also applies to a bonus or penalty, paid in the course of carrying on a business or earning income from property, in consideration of the early repayment of all or part of a borrowing or an unpaid purchase price for property. The portion of such penalty or bonus that relates to and does not exceed the value, at the time that such penalty or bonus is paid, of a payment of interest that would otherwise have been paid by the taxpayer in a future taxation year on such debt, shall be treated as an interest expense for such future taxation year. In the case of a repayment of borrowed money that was not used to acquire property, for the purpose of determining its deductibility, such interest will be considered to be paid or payable in a future year on borrowed money used in that year for the purpose for which the borrowed money that was repaid was used. In the case of a repayment of borrowed money that was used to acquire property or a repayment of an unpaid purchase price for property, for the purpose of determining deductibility, such interest will be considered to be paid or payable in a future year on such borrowed money or unpaid purchase price to the extent that the property or property substituted therefore is used by the taxpayer in that year for the purpose of earning income from the property or property substituted therefore or form a business.

Specifically excluded from the ambit of new subsection 18(9.1) is any fee, penalty or bonus that may reasonably be considered to have been paid for the extension of the term of a debt obligation or as consideration for the substitution or the conversion of a debt obligation into a another debt obligation or into a share. Also excluded is any fee, penalty or bonus that is contingent upon the use or production from property or is computed by reference to revenue, profit, cash flow, commodity price or any similar criterion or by reference to any dividends paid or payable on any class of shares of a corporation.

Any fee, penalty or bonus to which new subsection 18(9.1) applies will be treated as interest received by the recipient at the time that it is paid.

This subsection applies to payers of such amounts in respect of such amounts paid after 1984 and to recipients of such amounts in respect of such amounts paid after July 13, 1990.

Subclauses 13(7) and (8)

ITA
18(11)

Paragraphs 20(1)(c), (d), (e), (e.1) and (f) of the Act permit a deduction for interest and certain other financing expenses relating to borrowed money used by a taxpayer for the purpose of earning income from a business or property. These provisions are, however, subject to subsection 18(11) which prohibits the deduction of such expenses in respect of indebtedness incurred for the purpose of making a contribution to an RRSP or certain other deferred income plans.
Subsection 18(11) is amended to clarify that no deduction is allowed, in respect of interest expenses incurred to purchase income-producing property, after that property is transferred to any such deferred income plan. The preamble to subsection 18(11) is also amended to remove reference to paragraph 20(1)(k), which has been repealed, and to add a reference to paragraph 20(1)(e.1) in consequence of the addition of that paragraph to the Act.

These amendments apply to the 1990 and subsequent taxation years.

Clause 14

Advertising Expenses

ITA
19

Section 19 of the Act imposes certain limitations on the deductibility of expenses incurred for the purposes of advertising in non-Canadian newspapers or periodicals.

Paragraph 19(5)(b) of the Act defines the term "Canadian newspaper or periodical", which is relevant in determining whether the deductibility of the cost of advertising in publications owned by partnerships may be restricted. Subparagraph (ii) of this definition is amended to include (in addition to partnerships of Canadian citizens) partnerships of corporations referred to in subparagraph 19(5)(b)(v) and partnerships composed of a combination of such corporations and Canadian citizens as publishers of a Canadian newspaper or periodical. This amendment also changes the requirement that at least 3/4 of the members of a partnership owning the publication rights of a Canadian newspaper or periodical be Canadian citizens, to a requirement that at least 3/4 of the income or loss of the partnership from any source be included in the determination of the income of Canadian citizens or eligible corporations.

Subparagraph (v) of this definition is also amended to prevent the dilution of Canadian ownership of "Canadian" publications through tiers of private holding corporations. For the purposes of the tests for Canadian ownership contained in clause 19(5)(b)(v)(C), rules similar to the associated corporations rules will determine the number of shares of a corporation ultimately owned by Canadian citizens. For public corporations, a Canadian-control test will apply.

Clause 19(5)(b)(v)(C) is also amended to replace the reference of 3/4 of the paid-up capital of the issued shares of a corporation with a reference to 3/4 of the fair market value of such shares.

These amendments are generally applicable to publication rights acquired after July 13, 1990 or, where the holder of the rights so elects, after 1988.

In certain circumstances where shares of a corporation holding publication rights are acquired after July 13, 1990 by citizens or subjects of a country other than Canada or a company controlled by such persons, the corporation will be considered to have acquired those publication rights after that date.

Clause 15

Permitted Deductions - Business and Property Income

ITA
20

Section 20 of the Act provides rules relating to the deductibility of certain outlays, expenses and other amounts in computing a taxpayer's income for a taxation year from a business or property.

Subclause 15(1)

ITA
20(1)(c)(iv)

Subparagraph 20(1)(c)(iv) of the Act allows the deduction of interest expenses on money borrowed to acquire an annuity contract to which the income accrual rules apply.

Subparagraph 20(1)(c)(iv) is amended to clarify that it will apply for a year in respect of borrowed money used to acquire an interest in an annuity contract that would be subject to accrual taxation in the year, were it not for the fact that the contract did not have an anniversary day in the year and while held by the taxpayer. The amendment also removes a reference to paragraph 56(1)(d.1) of the Act, which was repealed in Bill C-28 (1989) with respect to annuity contracts acquired after 1989.

These amendments are applicable with respect to contracts last acquired after 1989.

Subclause 15(2)

ITA
20(1)(e.2)

New paragraph 20(1)(e.2) will permit a limited deduction in respect of life insurance premiums where the policy has been assigned as collateral for a loan. This amendment counters the 1987 decision of the Federal Court of Appeal in the case of Antoine Guertin Ltée. and will generally continue, with some modification, the administrative practice of Revenue Canada described in its Interpretation Bulletin IT-309R.

The new provision permits a deduction in respect of life insurance premiums under a policy which is assigned as collateral for a loan, provided that the assignment is required by the lender, the lender is a restricted financial institution (as defined in subsection 248(1)) and the interest payable on the money borrowed is or, but for the provisions of subsections 18(2) and (3.1) or sections 21 or 28, would be deductible in computing the taxpayer's income. The amount deductible in respect of such eligible premiums for a taxation year may not exceed the lesser of the premiums payable under the policy in respect of the year and the net cost of pure insurance in respect of the policy for the same period. Where the taxpayer's taxation year does not correspond to the policy year, the premiums payable under the policy should be pro-rated on a reasonable basis to the taxation year. Similarly, the net cost of pure insurance, which is determined by the insurer on a calendar year basis should be pro-rated on a reasonable basis to the taxation year.

After determining the ceiling amount in respect of the life insurance premiums as described above, the amount deductible is determined as that portion of the ceiling amount that may reasonably be considered to relate to the amount owing under the loan for which the insurance policy has been assigned as collateral. For example, where the life insurance coverage under the assigned policy is $500,000 and the average balance owing under the loan during the taxation year is $200,000, the amount deductible under new paragraph 20(1)(e.2) will be limited to 40% of the lesser of the premiums payable and the net cost of pure insurance for the policy in respect of the year.

It is intended that the net cost of pure insurance in respect of an interest in a life insurance policy be determined for these purposes in accordance with section 308 of the Regulations. The net cost of pure insurance, which is determined by reference to standard mortality assumptions, approximates the cost of the pure insurance coverage under the policy for the year. As a result, where the policy which has been assigned as collateral for a loan has a savings component or some form of pre-funding, the maximum deduction under the new paragraph would normally be limited by the net cost of pure insurance limitation.

New paragraph 20(1)(e.2) is applicable with respect to premiums payable after 1989.

Subclause 15(3)

ITA
20(1)(gg)

New paragraph 20(1)(gg) allows a taxpayer to deduct reasonable costs relating to eligible disability-related modifications to the taxpayer's building where the building is used to earn income from a business or property. The eligible modifications, which will be prescribed by regulation, include the installation of interior and exterior ramps and hand-activated power door openers, the widening of doorways and modifications to bathrooms for the benefit of individuals who have a severe and prolonged mobility impairment. Under the current income tax provisions, the cost of such modifications is claimed over a number of years through the capital cost allowance provisions. This amendment is applicable with respect to amounts paid for eligible modifications made after 1990.

Subclause 15(4)

ITA
20(1)(mm)

Paragraph 20(1)(mm) of the Act allows taxpayers to deduct, in computing their income for a taxation year, certain costs of substances injected into a natural reservoir to assist in the recovery of petroleum, natural gas or related hydrocarbons, where such costs are incurred in the year or a previous year. It is amended so that where a taxpayer has a taxation year of less than 51 weeks, the taxpayer's maximum claim otherwise determined under paragraph 20(1)(mm) is pro-rated according to the number of days in the year. The taxpayer is, however, permitted to deduct an amount equal to the total injected substance costs incurred in the year.

The pro-ration of the deduction under paragraph 20(1)(mm) is consistent with the pro-ration of resource deductions under subsection 66(13.1). The amendment prevents a deduction under paragraph 20(1)(mm) from being claimed by a taxpayer in a short taxation year in order to avoid the reduction in the taxpayer's resource allowance that would otherwise result from the deduction being claimed in a year in which the taxpayer has substantial resource profits.

This amendment applies to taxation years commencing after July 13, 1990.

Subclause 15(5)

ITA
20(1)(pp)

New paragraph 20(1)(pp) of the Act provides for a deduction by an employer in respect of amounts under a salary deferral arrangement included in its employees' income under paragraph 6(1)(i). This amendment, which applies to the 1986 and subsequent taxation years, is discussed in greater detail in the commentary on the amendment to paragraph 18(1)(o.1).

Subclause 15(6)

ITA
20(2.2)(c)

Subparagraph 20(1)(c)(i) of the Act provides a deduction in computing a taxpayer's income from business or property in respect of interest on borrowed money used for the purpose of earning such income, but specifically excludes any deduction in respect of interest on money borrowed to acquire a life insurance policy. The term "life insurance policy" is defined in paragraph 138(12)(f) of the Act and includes an annuity contract issued by an insurer where the insurer's reserves for such contracts are based on the fair market value of a specified group of assets. Subsection 20(2.2) of the Act creates certain exceptions to the definition of life insurance policy for the purposes of paragraphs 20(1)(c) and (d) which effectively permit interest on money borrowed to acquire certain insurance products to qualify for a deduction under those paragraphs.

New paragraph 20(2.2)(c), which applies to the 1987 and subsequent taxation years, provides an additional exception to the definition of life insurance policy for the purposes of paragraphs 20(1)(c) and (d) of the Act. Under this new paragraph, interest on money borrowed to acquire annuity contracts issued by an insurer whose reserves for such contracts vary in amount depending on the fair market value of a specified group of assets will, within normal limits, be deductible in computing income.

Subclause 15(7)

ITA
20(4)

Subsection 20(4) of the Act provides a deduction in computing the income of a taxpayer where it is established that an amount owing to the taxpayer as or on account of proceeds of disposition of depreciable property (other than timber resource property) has become a bad debt in the taxation year. The deduction is equal to the lesser of the amount owing to the taxpayer and the amount, if any, by which the capital cost to the taxpayer of the property exceeds the amounts realized on account of the proceeds of disposition.

This subsection is amended to prohibit a deduction in respect of a bad debt which has resulted from the disposition of a passenger vehicle having a cost to the taxpayer in excess of $20,000 or such other amount as may be prescribed, since there is no depreciation recapture with respect to such property. This amendment is applicable with respect to debts that are established after July 13, 1990 to have become bad.

Subclause 15(8)

ITA
20(16)

Subsection 20(16) of the Act provides rules for calculating a taxpayer's terminal loss at the end of a taxation year. The concluding words of that subsection are unnecessary as deductions made pursuant to subsection 20(16) are already included in the definition "total depreciation" in paragraph 13(21)(e). This amendment also clarifies that terminal losses are included in calculating a taxpayer's net aggregate income for the purposes of the rental, leasing and specified energy property rules. The amendment also resolves a circularity problem that arises because a taxpayer's income for the purpose of those rules is to be computed without regard to paragraph 20(1)(a) of the Act, while the concluding words of subsection 20(16) currently provide that terminal losses are treated as having been deducted under paragraph 20(1)(a).

This amendment applies to taxation years commencing after July 13, 1990.

Subclause 15(9)

ITA
20(20)

Subsection 20(20) of the Act provides a deduction in respect of income accrued but not received under certain life insurance policies at the time disposed of by the policyholder. Such accrued income is included in the policyholder's income under section 12.2 of the Act and is added to the cost base of the policy or annuity by virtue of subparagraph 148(9)(a)(iii.1), and any payments made under an annuity contract reduce the adjusted cost base of the annuity. This amendment extends the application of subsection 20(20), with effect for dispositions occurring after 1989, to accrued but unreceived income in respect of an annuity (other than a prescribed annuity) under which annuity payments have commenced at the time of disposition. Prescribed annuities are subject to the provisions of paragraphs 56(1)(d) and 60(a) of the Act, and are not subject to section 12.2.

Subclause 15(10)

ITA
20(21)(b)

Subsection 20(21) of the Act provides a deduction in computing a taxpayer's income for a taxation year in which a debt obligation is disposed of at fair market value, in respect of any previous over-accrual of interest on that debt obligation. Certain debt obligations contain early redemption provisions under which the holders are entitled to the full rate of interest stipulated on the debt obligation only if they hold the obligation to maturity. This subsection is amended to ensure that, in cases where a taxpayer redeems a debt obligation prior to its date of maturity and the holder is, as a result, not entitled to the full rate of interest stipulated on the debt obligation, a deduction with respect to the recovery of the interest paid by the borrower on the obligation is allowed in the year in which the obligation is redeemed. This amendment applies to the 1986 and subsequent taxation years.

Subclause 15(11)

ITA
20(28)

New subsection 20(28) of the Act provides a special rule relating to buildings which overrides the general available-for-use rules in section 13 of the Act and permits a taxpayer to claim certain amounts as capital cost allowance in respect of a building notwithstanding that the building is not yet available for use. The amount that may be claimed, pursuant to new subsection 20(28), as capital cost allowance for a year is restricted to the amount by which the lesser of the two amounts described below exceeds the amount of capital cost allowance that would have been deductible in respect of the building for the year in the absence of this subsection. The first of these amounts is the capital cost allowance that would have been allowed in respect of the building for the year but for the available-for-use rule provided in new subsection 13(26), and the second of these amounts is the taxpayer's income from the building for the year computed without reference to any deduction under subsection 20(28) (or under paragraph 20(1)(a) in respect of a portion of the building acquired before 1990) but after taking into account any deduction made under new subsection 20(29) concerning soft-costs.

New subsection 20(28) is applicable to taxation years ending after 1989. An example of the operation of this subsection along with the operation of new subsection 20(29) is provided with the commentary to that subsection, below.

ITA
20(29)

New subsection 20(29) of the Act provides a special rule relating to buildings which overrides the rules in subsection 18(3.1) of the Act requiring the capitalization of certain construction period "soft-costs". This new provision permits a taxpayer to deduct such soft-costs incurred in a year to the extent of the taxpayer's income from the rental of the building for the year computed without reference to this provision and before taking into account any deduction allowed under new subsection 20(28) in respect of certain capital cost allowance claims.

New subsection 20(29) applies to outlays and expenses made after 1989.

Example

An office tower is under construction. A portion of the building was acquired prior to 1990 and is not subject to the available-for-use rules. Only a portion of the building (less than 90%) is occupied and producing rental income. The owner of the building has received rental income of $200,000, before any deduction of capital cost allowance ("CCA"), and has incurred soft-costs of $150,000 in the year. The owner may claim $40,000 of CCA in respect of costs incurred before 1990 and could have claimed CCA of $80,000 in respect of costs incurred after 1989 had the available-for-use rules not applied. Pursuant to new subsections 20(28) and (29), the taxpayer may deduct from this rental income the following amounts:

Soft costs . lesser of soft-costs ($150,000)
and rental income ($200,000 - $40,000 = $160,000)

= $150,000

Plus CCA . amount by which the lesser of rental income, net of deductible soft-costs,
($200,000-$150,000 = $50,000), and

total CCA had the available-for-use rules not applied ($120,000)
= $50,000
exceeds
CCA deductible had subsection 20(28) not applied
($40,000)
= $10,000

If the soft-costs associated with the building were $225,000, the taxpayer could deduct from his rental income the following amounts:

Soft Costs .	lesser of soft-costs ($225,000) and rental income ($160,000) = $160,000
Plus CCA .	the amount by which the lesser of rental income, net of deductible soft-costs, ($200,000 - $160,000 = $40,000), and total CCA otherwise deductible ($120,000) = $40,000 exceeds CCA deductible had subsection 20(28) not applied ($40,000) = $0

The balance of the taxpayer's soft-costs ($65,000) would be added to the capital cost of the building pursuant to subsection 18(3.1) of the Act.

Clause 16

Cost of Borrowed Money

ITA
21

Section 21 of the Act allows a taxpayer to capitalize, instead of deducting as a current expense, the cost of borrowed money used to acquire depreciable property or used for exploration, development or the acquisition of a resource property. Subsections 21(1) to (4) are amended, as a consequence of the addition of paragraph 20(1)(e.1) to the Act, to allow a taxpayer to capitalize annual financing fees which relate to such expenditures and which would otherwise be deductible under that paragraph.

These amendments to section 21 of the Act apply after 1987.

Clause 17

Ceasing to Carry on Business

ITA
24

Subsection 24(1) of the Act provides a deduction, in computing the income of a taxpayer for the year in which the taxpayer ceased to carry on a business, in respect of the residual cumulative eligible capital of the taxpayer in respect of the business. This subsection is amended to defer its application until the taxpayer's first taxation year in which the taxpayer has not only ceased to carry on the business but has also disposed of all of the eligible capital property, other than property of no value, that was held by the taxpayer in respect of the ceased business.

Subsection 24(2) of the Act provides an automatic rollover of the cumulative eligible capital in respect of a business of a taxpayer who ceases to carry on the business in circumstances where the business is thereafter carried on by the taxpayer's spouse or a corporation controlled directly or indirectly by the taxpayer. Subsection 24(2) is amended to provide this automatic rollover only where all of the eligible capital property, other than property of no value, that was held by the taxpayer in respect of the business is transferred to the taxpayer's spouse or the corporation controlled directly or indirectly by the taxpayer.

These amendments to section 24 of the Act apply after July 13, 1990.

Clause 18

Farming or Fishing Business

ITA
28

Section 28 of the Act provides rules concerning the computation of income for taxpayers who use the cash-basis method of accounting in respect of farming or fishing businesses for income tax purposes.

Subclause 18(1)

ITA
28(1)

Subsection 28(1) is amended to provide that paragraphs 28(1)(b) (the optional inventory adjustment) and 28(1)(c) (the mandatory inventory adjustment) do not apply in a year in which a taxpayer has died. This amendment, which applies to fiscal periods commencing after 1988, provides consistency with subsections 70(2) and (3) of the Act concerning rights or things owned by a taxpayer at the time of death. Those subsections include the value of rights or things, such as a farmer's inventory, in the taxpayer's income for the year of death if an election is not made to transfer the rights or things to the taxpayer's beneficiaries. If such an election is made, no such income inclusion is required but the beneficiaries must include in their income any eventual proceeds of disposition of the rights or things.

Subclauses 18(2) and (3)

ITA
28(1.1)

Subsection 28(1.1), which provides a definition of a taxpayer's inventory for the purposes of section 28, is repealed as a consequence of amendments to the definition "inventory" in subsection 248(1) of the Act. This amendment applies to fiscal periods commencing after 1988.

New subsection 28(1.1) of the Act provides that where inventory is acquired, in curcumstances where paragraph 69(1)(a) or (c) of the Act applies, by a farmer who computes income in accordance with the cash method of accounting, the acquired inventory is deemed to have been purchased and paid for. The taxpayer is therefore allowed to deduct the fair market value of the inventory and is required to consider such acquired inventory as purchased inventory for the purposes of the mandatory inventory adjustment in paragraph 28(1)(c) of the Act. The mandatory inventory adjustment generally reduces a farm loss, computed in accordance with the cash method of accounting, by the lesser of the loss and the fair market value of purchased inventory on hand at year end.

Subsection 69(1) of the Act provides rules governing transactions entered into for inadequate consideration. Paragraph 69(1)(a) of the Act provides that where a taxpayer has acquired anything from a non-arm's length person at an amount in excess of its fair market value, the taxpayer is treated as having acquired the property at that fair market value. Paragraph 69(1)(c) of the Act provides that where a taxpayer acquires porperty as a gift, bequest or inheritance, the taxpayer is treated as having acquired that property at its fair market value at the time the taxpayer so acquired it.

New subsection 28(1.1) is applicable to taxation years and fiscal periods ending after 1990.

Subclause 18(4)

ITA
28(1.2)

Subsection 28(1.2) of the Act provides rules for valuing the inventory of cash-basis farmers for the purpose of paragraph 28(1)(c). A special rule applies to the valuation of "specified animals", which include all horses and, where a taxpayer so elects, bovine animals registered under the Animal Pedigree Act. This subsection formerly referred to the Livestock Pedigree Act, which was replaced with the Animal Pedigree Act on July 1, 1988.

This amendment clarifies that such an election with respect to a particular animal is effective for the taxation year for which the election is made and all subsequent taxation years, and is not required to be made annually. This amendment also ensures that all amounts paid on account of the purchase price of an animal before the end of a particular year, including amounts paid after the year of acquisition, will be included in calculating the value of the animal at the end of that particular year.

This amendment applies to fiscal periods commencing after 1988.

Subclause 18(5)

ITA
28(4) and (4.1)

Subsection 28(4) of the Act applies to taxpayers who carried on a business the income from which was computed in accordance with the cash method and who cease to carry on the business or a part of the business and cease to reside in Canada. Subsection 28(4) requires such taxpayers to include the value of their inventory and accounts receivable in their income for the year in which they cease to reside in Canada. This subsection is repealed and replaced by new subsection 28(4), concerning accounts receivable, and new subsection 28(4.1), concerning inventory.

ITA
28(4)

New subsection 28(4) of the Act applies, under certain conditions, to require the inclusion of the value of a taxpayer's accounts receivable in calculating the taxpayer's income for a taxation year. These conditions will be met where a taxpayer who carried on a business the income from which was computed in accordance with the cash method is, at the end of the year, both not resident in Canada and not carrying on the business in Canada. For example, this subsection may apply where:

- a Canadian resident ceases to carry on a Canadian farming business and becomes non-resident,

- a Canadian resident ceases to carry on a farming business in another country and becomes non-resident, or

- a non-resident ceases to carry on a Canadian farming business.

This test will apply annually with respect to accounts receivable outstanding during each taxation year, but will only require the inclusion in a taxpayer's income of amounts that were not so included in a preceding year. As noted above, the amount included in a taxpayer's income under new subsection 28(4) is based on the <u>value</u> of the taxpayer's accounts receivable and, as a result, may be affected by evidence that a particular debt is doubtful or uncollectible.

Subsection 28(4) applies with respect to taxpayers who cease to reside in Canada, or cease to carry on business in Canada, after July 13, 1990.

ITA
28(4.1)

New subsection 28(4.1) of the Act applies, under certain conditions, to treat a taxpayer as having disposed of inventory owned by the taxpayer for proceeds of disposition equal to its fair market value. These conditions will be met at any time when property that is inventory of a taxpayer who carried on a business the income from which was computed in accordance with the cash method is not used by the taxpayer in a business carried on in Canada and the taxpayer is not resident in Canada. For example, this subsection may apply where:

- a Canadian resident carrying on business in Canada becomes non-resident and moves some or all of the inventory of the Canadian business to another country (note that the taxpayer may or may not have ceased to carry on the Canadian business),

- a Canadian resident carrying on business in another country becomes non-resident, or

- a non-resident carrying on business in Canada moves some or all of the inventory of the Canadian business to another country.

Subsection 28(4.1) is applicable with respect to taxpayers who cease to reside in Canada, and property that ceases to be used in connection with a business carried on in Canada, after July 13, 1990.

Clause 19

Insurance Brokers' Reserves

ITA
32

Subsection 32(1) of the Act provides a reserve in respect of "unearned commissions" for taxpayers that carry on a business as an insurance agent or broker. This subsection is amended, applicable to taxation years ending after 1990, to limit the reserve amount to the lesser of: an amount that is based on a proration of the taxpayer's commissions over that part of the term of each insurance contract that falls in subsequent taxation years; and the amount that would have been deductible under paragraph 20(1)(m) of the Act if a deduction under that paragraph were available to insurance agents and brokers. Under paragraph 20(1)(m), a taxpayer generally may deduct a reserve where an "unearned" receipt is required to be included in income pursuant to paragraph 12(1)(a) of the Act and the taxpayer will be rendering services after the taxation year-end.

To the extent that amended subsection 32(1) constrains the ability of affected insurance brokers to claim a reserve, new subsection 32(3) of the Act provides for a 10 year phase-in of the impact of the amendments. This is accomplished by allowing a taxpayer to deduct an additional reserve of a specified percentage of the difference between the taxpayer's subsection 32(1) reserve for the 1990 taxation year and the reserve deductible under new subsection 32(1) for the 1991 taxation year. To the extent that a taxpayer claims an additional reserve for a year, it must be included in the income of the taxpayer for the immediately subsequent taxation year.

Clause 20

International Banking Centres

ITA
33.1

Section 33.1 of the Act provides rules relating to the computation of a taxpayer's income or loss from an international banking centre ("IBC") business.

Subclause 20(1)

ITA
33.1(1)

The definition "eligible deposit" in subsection 33.1(1) of the Act limits the deposits qualifying for an IBC business to those received by a taxpayer from a non-resident person with whom the taxpayer deals at arm's length. Subparagraph (iii) of this definition requires that the taxpayer have no reasonable cause to believe that the deposit was made on behalf of, for the benefit of or as a condition of a transaction with anyone other than a non-resident. The amendment to subparagraph (iii), which applies to deposits recorded in an IBC business after July 13, 1990, requires that any third party with an interest in such a deposit must also be a person with whom the taxpayer deals at arm's length.

Subclause 20(2)

ITA
33.1(7)

Subsection 33.1(7) of the Act imposes a limitation on a taxpayer's right under subsection 33.1(6) to treat eligible deposits recorded in the books of one IBC business of the taxpayer on a particular day as having been recorded in the books of another IBC business of that taxpayer for that day. In its present form, subsection 33.1(7) permits the transfer of eligible deposits only to the extent that such deposits exceed the total amount of outstanding loans, although, pursuant to subsection 33.1(5), a full deduction in respect of a taxpayer's income from a particular IBC business can be achieved by maintaining eligible deposits equivalent to 96% of eligible loans.

This amendment, which applies to taxation years commencing after December 17, 1987, allows such transfers to the extent that the aggregate amount of eligible deposits held by an IBC business on a particular day exceeds 96% of outstanding eligible loans on that day.

Clause 21

Scientific Research and Experimental Development

ITA
37

Section 37 of the Act sets out rules relating to the deductibility of expenditures on scientific research and experimental development.

Subclause 21(1)

ITA
37(1)(a)

Amendments to section 37 introduced effective after December 15, 1987 ensured that, in order to qualify for a deduction under section 37, an R&D expenditure must be related to a business of the taxpayer making the expenditure. This new requirement may impose administrative difficulties upon non-profit research and development corporations established to perform pre-competitive basic research on R&D on behalf of corporate members. The object of these pre-competitive R&D consortia is to perform selected projects of basic, pre-competitive, R&D research on behalf of corporate members whose payments would not be traceable to specific projects. Section 37 is amended, therefore, to provide for the deductibility of payments made by a corporation to a non-profit R&D corporation for pre-competitive basic research to be performed for their future use in augmenting R&D projects that are more clearly related to the business of the payor.

These amendments are applicable in respect of payments made after December 15, 1987.

Subclause 21(2)

ITA
37(1.2)

New subsection 37(1.2) of the Act provides that no deduction may be made pursuant to section 37 of the Act in respect of an expenditure of a capital nature on scientific research and experimental development until such time as the property acquired with the expenditure is considered to have become "available for use" within the meaning provided in new subsections 13(27) to (31). The determination of the time at which a property is considered to be available for use in described in the commentary to those subsections.

New subsection 37(1.2) of the Act is generally applicable with respect to expenditures made after 1989.

Clause 22

Capital Gains and Losses

ITA
39

Section 39 of the Act sets out the meaning of capital gain, capital loss and business investment loss and provides a number of special rules relating to capital gains.

Subclause 22(1)

ITA
39(1)(a)(i.1)

Subparagraph 39(1)(a)(i.1) of the Act provides that no capital gain arises on the disposition to designated institutions and public authorities of an object that is certified cultural property. Subparagraph 39(1)(a)(i.1) refers to sections of the Cultural Property Export and Import Act, and is amended as a consequence of the re-numbering of that Act. Clause 39(1)(a)(i.1)(A) is also amended to extend the period during which the disposition of the property may occur after a taxpayer's death, consistent with earlier amendments to similar provisions contained in section 70 of the Act.

These amendments apply to dispositions occurring after December 11, 1988.

Subclause 22(2)

ITA
39(1)(c)

Paragraph 39(1)(c) of the Act defines a taxpayer's business investment loss for the year as his capital loss for the year from a disposition to which subsection 50(1) applies, or to a person with whom the taxpayer was dealing at arm's length, of shares or debt of a small business corporation. For the purposes of paragraph 39(1)(c), a small business corporation, as defined in subsection 248(1) of the Act, includes a corporation that was a small business corporation at any time in the 12-month period proceeding the disposition.

This 12-month period is intended to permit investors in a small business corporation to claim a business investment loss on the disposition of the shares or debt of the corporation where it ceases to carry on an active business because it has become bankrupt or its being wound-up prior to the disposition.

The amendment to subparagraph 39(1)(c)(iv), which applies to the 1987 and subsequent taxation years, extends, in certain circumstances, the application of paragraph 39(1)(c) to capital losses on disposition of debts of corporations that have ceased to qualify as small business corporations. Where the corporation was a small business corporation when it became a bankrupt or when a winding-up order was made, by reason of the corporation's insolvency, in respect of it under the Winding-up Act, any capital loss realized by the taxpayer on a disposition of a debt of the corporation will be eligible for treatment as a business investment loss.

Subclause 22(3)

ITA
39(4.1)

Subsection 39(4) of the Act allows certain taxpayers to treat all their Canadian securities as capital property and to treat any gain or loss arising on disposition of such a security as a capital gain or loss. New subsection 39(4.1), which applies with respect to dispositions of securities after July 13, 1990, clarifies the treatment of Canadian securities held by partnerships. In such a case, each partner will be treated as owning the security and each partner will be treated as disposing of the security. In addition, subsection 96(3) of the Act, which provides a mechanism for a partner electing on behalf of all members of the partnership for certain provisions of the Act and for treating each member of the partnership as having made such an election, is being amended to remove the reference to subsection 39(4). As a result of this change, each member of a partnership will elect on his own behalf under subsection 39(4) and the treatment of his share of the gain or loss from a disposition of a Canadian security held by the partnership will depend on whether he has elected under subsection 39(4). An election by a member of a partnership in respect of a Canadian security held by the partnership will not longer result in each member of the partnership being treated as having made the election.

Subclause 22(4)

ITA
39(12)

New subsection 39(12) of the Act provides a special rule that applies for the purposes of the provisions relating to business investment losses.
Paragraph 39(1)(c) defines a taxpayer's business investment loss for the year as his capital loss for the year from disposition of shares or debt of a small business corporation to an arm's length person or from a disposition to which subsection 50(1) of the Act applies. For the purposes of paragraph 39(1)(c), a small business corporation includes a corporation that was a small business corporation as defined in subsection 248(1) at any time in the 12-month period preceding the disposition of the shares or debt.

In the case of a payment made by a taxpayer under a guarantee in respect of a corporation's liabilities, a debt does not arise between the corporation and the taxpayer until the payment is made. In such a case, the 12-month period may not allow sufficient time for the creditor to dispose of his debt or to establish that it has become bad so that it may be treated as having been disposed of by reason of subsection 50(1) of the Act. For example, where the guarantor contests his liability under the guarantee or where the payments under the guarantee are to be made over a period of time, the corporation may no longer qualify as a small business corporation by reason of its having become inactive at the time the payment is made under the guarantee.

New subsection 39(12) will treat a payment made by a taxpayer under an arm's length guarantee of the debts of a corporation as a debt owing by a small business corporation where the corporation was a small business corporation both at the time the debt in respect of which the payment was made was incurred and at any time in the 12 months before the time an amount first became payable under the guarantee. Where these conditions are met, the taxpayer will be eligible to claim a business investment loss on any payments made under the guarantee even where the corporation has ceased to carry on an active business. New subsection 39(12) applies with respect to amounts paid after 1985.

Clause 23

Capital Gains - Special Rules

ITA
40(3)

Subsection 40(3) of the Act provides rules relating to capital properties whose adjusted cost base in a year has been reduced below nil as a result of the adjustments required under subsection 53(2) of the Act. In such cases this "negative" adjusted cost base is generally treated as a capital gain of the taxpayer.

The amendment to subsection 40(3), which applies to the 1987 and subsequent taxation years, treats the taxpayer, for the purposes of section 93, paragraph 95(1)(b) and section 110.6 of the Act, as having disposed of the property for proceeds of disposition equal to the negative adjusted cost base. This change is strictly technical. It ensures that an election under subsection 93(1) may be made by a corporation resident in Canada to treat a portion of the gain arising in respect of shares of a foreign affiliate as a dividend.

Clause 24

Exchanges of Property

ITA
44

Section 44 of the Act allows a taxpayer to defer the recognition of a capital gain in respect of certain property where a "replacement property" is acquired.

Subclause 24(1)

ITA
44(1)(e)(iii)

Paragraph 44(1)(e) of the Act governs the computation of a taxpayer's capital gain upon the disposition of a capital property where another capital property is acquired as a replacement property. Subparagraph 44(1)(e)(iii) is amended to require that any amount claimed under paragraph 44(1)(e) by an individual, as a capital gain reserve for proceeds of disposition that are not due until a subsequent taxation year, is to be made in the form prescribed by the Minister of National Revenue. This amendment applies to the 1990 and subsequent taxation years.

Subclause 24(2)

ITA
44(5)

Subsection 44(5) of the Act describes the conditions under which a capital property acquired by a taxpayer will be a "replacement property" for the purposes of section 44. The replacement property rules under subsection 44(1) of the Act allow a taxpayer to defer recognition of capital gains in respect of the disposition of a capital property when that property is replaced by a similar property within a specified time period.

Paragraph 44(5)(a) of the Act is amended to extend the replacement property rules relating to capital properties, where the former property was used for the purpose of producing business or property income, to circumstances where the use for which the replacement property was acquired is the same as or similar to the use made of the former property by a person related to the taxpayer.

Paragraph 44(5)(b) of the Act is amended to extend the replacement property rules relating to capital properties, where the former property was used for the purpose of producing business income, to circumstances where the similar use for which the replacement property is used is carried on by a related person.

Paragraph 44(5)(c) of the Act is, generally, amended to restrict the benefit of the replacement property rules aplicable with respect to capital property to replacement properties that meet the definition of "taxable Canadian property" in paragraph 115(1)(b) of the Act. The application of this restriction is, however, limited to circumstances where the former property was taxable Canadian property or would have been taxable Canadian property if the taxpayer were non-resident throughout the year in which the former rpoperty were used in business carried on by the taxpayer.

The amendments to paragraphs 44(5)(a) and (b) are applicable with respect to dispositions of former properties occurring after July 13, 1990.

The amendments to paragraph 44(5)(c) are generaly applicable to replacement properties for former properties disposed of after April 2, 1990.

Clause 25

Property with More than One Use

ITA
45(1)(c)

Subsection 45(1) of the Act provides for a deemed disposition and reacquisition of property when its use, or the proportion of its use, is altered from personal use to income earning or producing use, or vice versa. Subparagraph 45(1)(c)(i) was inadvertently repealed by Bill C-139 (1988) and is now reinstated by this amendment. In addition, subparagraph 45(1)(c)(ii) provides for the deemed disposition of property, where there has been a change in the relation between the use regularly made by a taxpayer for the purpose of gaining or producing income and the use regularly made for other purposes, where the use regularly made by the taxpayer of the property for other purposes decreases, but fails to provide for a deemed reacquisition of the property. This amendment corrects that technical deficiency by providing for a deemed reacquisition of the property in an amount equal to the proceeds of the deemed disposition.

This amendment is applicable with respect to the 1972 and subsequent taxation years.

Clause 26

Gains on Shares of Corporation Becoming Public

ITA
48.1

New section 48.1 of the Act is intended to ensure that owners of qualified small business corporation shares do not lose their entitlement to the special $500,000 capital gains exemption in respect of gains accrued but not realized on their shares prior to the corporation becoming a public corporation.

In order to claim this special exemption provided under subsection 110.6(2.1) of the Act, it is necessary that the corporation be a small business corporation at the time the taxpayer disposes of his or her shares in the corporation. Shares of a public corporation can never constitute qualified small business corporation shares. The potential loss of the availability of the enhanced exemption has been considered by some to be an impediment to raising funds on a prescribed stock exchange.

New section 48.1 allows a taxpayer who is an individual to elect to have disposed of his or her small business corporation shares immediately prior to the corporation going public. An individual who makes this election must also specify the proceeds of disposition of the shares. Where the fair market value of the shares immediately prior to the corporation going public is greater than the individual's adjusted cost base of the shares, the individual may specify any amount from the adjusted cost base up to the fair market value of the shares proceeds of disposition. Thus the individual can control the amount of his or her taxable capital gain that will be brought into income in respect of the elected disposition, and match that gain to the availability of the capital gains exemption. Where the election is made, the individual will be treated as having reacquired the shares immediately after the elected disposition at a cost equal to the amount specified.

For the election to be available, the shares must be capital property to the taxpayer. Further, the election must be filed with the individual's return of income for the year in which the corporation goes public.

In order to avoid any penalty, the election must be filed on or before the individual's balance due day for the taxation year in which the corporation goes public -- generally, April 30th of the following year. Late filed elections will be permitted for the 2 years following that balance due day, but will be subject to a penalty of 1/4 of 1% of the individual's capital gain resulting from the elected disposition for each month, or part thereof, during the period the election is late, to a maximum of $100 per month or part thereof. The individual must pay the estimated amount of this penalty when the late-filed election is made.

The elected disposition will not apply for the purposes of sections 7 and 35 and paragraph 110(1)(d.1) of the Act, which deal with shares acquired under an employee stock option plan or certain shares owned by a prospector or grubstaker. This exclusion ensures that the elected disposition will not trigger an income inclusion under those provisions.

New section 48.1 is applicable to the 1991 and subsequent taxation years.

Clause 27

Options

ITA
49

Section 49 of the Act provides rules dealing with the granting, expiry, exercise and renewal of options.

Subclauses 27(1), (2) and (4)

ITA
49(1), (2.1) and (5)

Section 49 of the Act provides a number of rules with respect to options. The granting of an option in a year by a taxpayer is generally deemed to be the disposition of property by the taxpayer in that year. However, if an option is subsequently exercised, the deemed disposition is considered not to have occurred and the cost or consideration in respect of the option is treated as if it were the cost or consideration in respect of the property to which the option relates. In such a case, in the event an option is exercised by a taxpayer in a taxation year subsequent to the year in which it was granted, provision is made for the refiling of the taxpayer's tax return for the year in which the option was granted.

There is, however, an exception to this rule where a corporation grants an option to another person to acquire shares of its capital stock. In this case, the granting of the option is not considered to be a disposition of property. A disposition of such property by the corporation will be deemed to have occurred under subsection 49(2) only if such an option expires.

Section 49 is amended to provide the same treatment for trust units. Thus, an option granted to a person by a trust to acquire units in the trust is treated in the same manner as an option granted by a corporation to acquire shares in its capital stock.

These amendments apply in respect of options granted after 1989.

Subclause 27(3)

ITA
49(3)(b)

Paragraph 49(3)(b) of the Act provides that where an option has been exercised the adjusted cost base of the option shall be added to the cost of property acquired by exercising the option.

Paragraph 49(3)(b) is amended, applicable after July 13, 1990, to restrict its application where the property acquired on the exercise of the option is a share, the adjusted cost base of which to the purchaser was increased by reason of paragraph 53(1)(j) of the Act. This amendment ensures that there is not a duplication of additions to the adjusted cost base of a share where paragraph 53(i)(j) provides for an addition to the cost base of the share as a result of the application of section 7 (stock option benefits).

Clause 28

Shares of Insolvent Corporations

ITA
50(1) and (1.1)

Paragraph 50(1)(b) of the Act treats a taxpayer as having disposed of a share of the capital stock of a corporation at the end of the year in certain circumstances and as having reacquired it at a nil cost immediately thereafter. In these circumstances, a shareholder is allowed to recognize a capital loss on the shares of a corporation even though he has not actually disposed of them.

Subparagraph 50(1)(b)(iii) provides that shareholders of a corporation that has ceased to carry on business and is insolvent during the year will be treated as having disposed of their shares at the end of the year where certain conditions are met. Three changes are being made to this subparagraph. The first change replaces the requirement that the corporation must have ceased to carry on business during the year with the requirement that neither the corporation nor a corporation controlled by it carries on business. This change extends the application of subparagraph 50(1)(b)(iii) to shares of holding corporations.

The second change to subparagraph 50(1)(b)(iii) adds a new clause (B) which provides that the taxpayer must elect to have subsection 50(1) apply in his return of income under Part I for the year the conditions in subparagraph 50(1)(b)(iii) are met. Where a taxpayer does not elect under clause 50(1)(b)(iii)(B) in the first year the conditions in subparagraph 50(1)(b)(iii) are met he will not be precluded from claiming that loss on a subsequent disposition of the share or a disposition treated as having occurred under subparagraph 50(1)(b)(i), (ii) or (iii).

The third change to subparagraph 50(1)(b)(iii) removes the requirements formerly contained in clause 50(1)(b)(iii)(B) that the corporation must not commence to carry on business in the year or within 24 months following the end of the year in which the disposition is treated as having occurred under subsection 50(1). This requirement resulted in administrative difficulties since it required a monitoring of subsequent events in order to determine whether a loss was currently deductible. New subsection 50(1.1) has been introduced to deal with this issue. Instead of denying the loss where the taxpayer does not meet this condition, new subsection 50(1.1) will result in the taxpayer realizing an offsetting gain by treating him as having disposed of the share at its adjusted cost base determined before the disposition previously deemed to have been realized under subsection 50(1).

The amendments to subparagraph 50(1)(b)(iii) are generally applicable to the 1990 and subsequent taxation years. Where, however, the taxpayer elects by notifying the Minister of National Revenue in writing before 1992, subparagraph 50(1)(b)(iii) will be applicable to the taxpayer's 1985 to 1989 taxation years. This election will not be available in respect of such a year where the corporation or a corporation controlled by it carried on business within 24 months from the end of that year.

New subsection 50(1.1) is added as a result of amendments to subparagraph 50(1)(b)(iii). New subsection 50(1.1) applies where a taxpayer was previously treated as having disposed of a share of a corporation by reason of subparagraph 50(1)(b)(iii) and the corporation or a corporation controlled by it commences to carry on business within 24 months of the disposition. In such a case where the taxpayer or a person with whom the taxpayer was not dealing at arm's length owns the share at the time the business is commenced he will be treated as having disposed of the share. The proceeds of disposition of the share will be equal to the adjusted cost base of the share prior to the disposition that was treated as having occurred by reason of subparagraph 50(1)(b)(iii). As a result, a taxpayer who owns a share of a corporation and who has previously realized a loss on a disposition of the share by reason of subparagraph 50(1)(b)(iii) will be treated as having realized an offsetting gain under new subsection 50(1.1) whenever the corporation or a corporation controlled by it commences to carry on business within the 24 month period following the subsection 50(1) disposition. Where the share has been transferred by the taxpayer to another person with whom he was not dealing at arm's length and that person owns the share then that other person will be treated as having disposed of the share. New subsection 50(1.1) is applicable to the 1990 and subsequent taxation years.

Clause 29

Cost of Shares

ITA
52(3)(a)

Subsection 52(3) of the Act establishes the cost of a share received as a stock dividend by the shareholder of a corporation. This amendment adds new paragraph 52(3)(a.1) which provides that the cost of a stock dividend which is not a dividend (within the meaning of the term "dividend" in subsection 248(1) of the Act, as amended by this Bill) is nil. The purpose of new paragraph 52(3)(a.1), which applies to stock dividends received after May 23, 1985, is to ensure that shares received by way of stock dividends are treated as having a cost that represents the amount included in computing the recipient's income under paragraph 82(1)(a) in respect of such dividends.

Clause 30

Adjustments to Cost Base

ITA
53

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

Subclause 30(1)

ITA
53(1)(e)(ix)

Paragraph 53(1)(e) of the Act provides that the adjusted cost base of a taxpayer's interest in a partnership is increased by various amounts, including the taxpayer's share of governmental assistance related to a Canadian resource property or an exploration or development expense incurred in Canada. The reason for such increase under subparagraph 53(1)(e)(ix) is that such assistance is recognized through a reduction in the taxpayer's cumulative Canadian exploration expense (CEE), cumulative Canadian development expense (CDE) or cumulative Canadian oil and gas property expense (COGPE).

Subparagraph 53(1)(e)(ix) is amended so that the adjusted cost base of a taxpayer's partnership interest is decreased in the event that assistance which caused an increase in the adjusted cost base of the interest is repaid pursuant to a legal obligation to repay all or part of the amount. The reason for such decrease is that the repayment of such assistance is now explicitly recognized through an increase in the taxpayer's cumulative CEE, CDE or COGPE under new subparagraph 66.1(6)(b)(iv.1), 66.2(5)(b)(iii.1) or 66.4(5)(b)(iii.1).

This amendment is applicable for the purposes of computing the adjusted cost base of a partnership interest after January 1990.

Subclause 30(2)

ITA
53(1)(f)

Paragraph 53(1)(f) of the Act adds to the adjusted cost base of a taxpayer's property that is substituted property any superficial loss that was realized by the taxpayer, the taxpayer's spouse or, where the taxpayer is a corporation, a person who controlled the corporation, on the disposition pursuant to which the taxpayer acquired the property. A superficial loss is defined in paragraph 54(i) and is effectively denied by being considered for tax purposes to be nil under paragraph 40(2)(g).

Subsections 112(3), (3.1) and (3.2) apply to reduce the amount of the loss otherwise determined from the disposition of a share that is a capital property where certain dividends have been paid on that share. Where the loss from the disposition of a share is both a superficial loss and a loss to which subsection 112(3), (3.1) or (3.2) applies, the addition to the adjusted cost base of the substituted property under paragraph 53(1)(f) should be reduced by any reductions to that loss required to be made under subsection 112(3), (3.1) or (3.2).

The amendment to paragraph 53(1)(f) is strictly technical. It provides that the addition under that paragraph to the adjusted cost base of property that is substituted property will be reduced by any reduction to the loss of a taxpayer that would have occurred under subsection 112(3) if paragraph 40(2)(g) had not first treated the loss as being nil. Similarly, where the taxpayer is a partnership or a trust, this addition will take into account any reduction to the loss of a corporate member of the partnership or a corporate beneficiary of the trust that was made under subsection 112(3.1) or (3.2). This amendment applies in computing the adjusted cost base of property after July 13, 1990.

Subclauses 30(3) and (4)

ITA
53(1)(h)

The amendments to paragraph 53(1)(h) are strictly technical. Subparagraph 53(1)(h)(i) of the Act, which provides for an addition to the adjusted cost base of land in respect of carrying charges for which a deduction is denied by reason of subsection 18(2), is amended as a consequence of amendments to subsection 18(2) to ensure that the terminology used in the two provisions is consistent.

Paragraph 53(1)(h) is further amended to refer to an amount that was "added to" rather than "included in" the cost of any property, in order to provide consistency with the preamble to subsection 53(1) which refers to amounts that are to be added to the cost of property. These amendments apply to taxation years ending after 1987.

Subclause 30(5)

ITA
53(2)

Subparagraph 53(2)(a)(ii) reduces the adjusted cost base to a taxpayer of a share of the capital stock of a corporation by the amount received by the taxpayer on a reduction of the paid-up capital in respect of the share except to the extent the amount received is treated as a dividend under subsection 84(4). Subsection 84(4) allows the shareholders of a class of the capital stock of a corporation resident in Canada, other than a public corporation, to receive an amount from the corporation as a tax-free return of capital provided the payment doesn't exceed the reduction in the paid-up capital of the class. In the case of an amount received by a taxpayer on a reduction of the paid-up capital of a share of the capital stock of a public corporation, subsection 84(4.1) treats the amount received as a dividend. The amendment to subparagraph 53(2)(a)(ii), applicable for the purpose of computing the adjusted cost base of a share after 1989, ensures that amounts treated as being received by a taxpayer as a dividend on a share under subsection 84(4.1) will not also reduce the adjusted cost base of the taxpayer's share.

Clause 31

Superficial Loss

ITA
54(i)

Paragraph 54(i) of the Act provides the definition of a taxpayer's "superficial loss". Pursuant to paragraph 40(2)(g) of the Act, a taxpayer's loss from the disposition of property, to the extent that it is a superficial loss, is considered to be nil.

Subparagraph 54(i)(i) has been amended by deleting the word "whether" from the phrase "controlled, whether directly or indirectly in any manner whatever" therein. This amendment, which applies to taxation years commencing after 1988, ensures consistency between the wording of this subparagraph and that of subsection 256(5.1) of the Act, and clarifies that the so-called de facto control test set out in that subsection is applicable for the purpose of the superficial loss rules.

Clause 32

Other Income

ITA
56

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

Subclause 32(1)

ITA
56(1)(a)(i)(C.1)

New clause 56(1)(a)(i)(C.1) of the Act generally requires that payments received by a taxpayer in respect of a foreign retirement arrangement be included in computing the income of the taxpayer as a superannuation or pension benefit. As defined in subsection 248(1), a foreign retirement arrangement is a prescribed plan or arrangement. For this purpose, it is intended to prescribe Individual Retirement Accounts referred to in subsections 408(a), (b) and (h) of the United States Internal Revenue Code.

Where a payment in respect of a foreign retirement arrangement established under the laws of a foreign country would not be subject to income taxation in that country if the recipient were resident therein, that payment is not included in income pursuant to the new rule. This exception may apply where payments are transferred from one foreign retirement arrangement to another. It may also apply where an individual receives a return of contributions from a foreign retirement arrangement established under the laws of a foreign country in respect of which the individual was not initially entitled to a deduction under the laws of that country.

A lump sum payment from a foreign retirement arrangement that is included in income pursuant to the new rule may generally be transferred to a registered retirement savings plan or registered pension plan. In this regard, see the commentary on the amendment to subparagraph 60(j)(ii) and on new section 60.01.

This amendment is applicable in respect of payments received after July 13, 1990.

Subclause 32(2)

ITA
56(1)(a)(iv)

Subparagraph 56(1)(a)(iv) of the Act requires unemployment benefits to be included in the income of the beneficiary. The Unemployment Insurance Act provides for the payment of tuition costs to educational institutions as part of various programs designed to facilitate the re-entry into the labour force of beneficiaries under that Act. This amendment ensures that, where such a payment is made for the benefit of an unemployed individual, it will not be included in the individual's income. This amendment applies to the 1988 and subsequent taxation years.

Subclause 32(3)
ITA
56(1)(a)(vii)

An amendment to the Department of Labour Act, enabling the Minister of Labour to provide income assistance to eligible older workers under the Program for Older Worker Adjustment, received Royal Assent in June 1989. This consequential amendment to paragraph 56(1)(a) of the Income Tax Act provides that such income assistance payments received after September 14, 1989 are taxable in the year in which they are received by the beneficiary.

Subclause 32(4)

ITA
56(1)(d) and (d.1)

Paragraphs 56(1)(d) and (d.1) of the Act require certain amounts received in respect of annuity payments to be included in the income of a taxpayer for a taxation year. Paragraph 56(1)(d) is amended to clarify that an annuity contract that would be subject to accrual taxation in a year, were it not for the fact that the contract did not have an anniversary day in the year and while held by the taxpayer, will not be subject to the provisions of the paragraph in that year. This amendment is applicable with respect to contracts last acquired after 1989.

Subclause 32(5)

ITA
56(1)(n)

Where an artist receives a project grant in circumstances where the grant constitutes neither business nor employment income, the grant is included in the taxpayer's income pursuant to paragraph 56(1)(n) of the Act (subject to the $500 "scholarship" exemption).

Paragraph 56(1)(n) is amended, applicable to the 1987 and subsequent taxation years, to provide that artists who receive project grants which are included in their income by reason of that paragraph will be allowed to deduct reasonable expenses incurred to fulfil the conditions of the grant, not exceeding the amount of the grant.

Subclause 32(6)

ITA
56(1)(u)

As a general rule, social assistance payments are included under paragraph 56(1)(u) of the Act in computing net income and an equivalent deduction is provided under paragraph 110(1)(f) of the Act in computing taxable income. The purpose of this system is to ensure that such payments are not subject to income tax but are taken into account for the purposes of determining the amount of certain refundable and non-refundable tax credits. Recent amendments have been made to ensure that amounts received in respect of a foster person are generally not included in income, thus preventing a reduction in the amount of the income tax credits otherwise available to the caregiver. The amendment to paragraph 56(1)(u) requires that all social assistance payments described in that paragraph be included in income while an amendment to subsection 81(1) of the Act (described in the commentary on new paragraph 81(1)(h)) clarifies the tax-exempt status of payments made in respect of foster persons. These amendments are applicable to the 1982 and subsequent taxation years.

Subclause 32(7)

ITA
56(1)(aa)

Subsection 56(1) of the Act requires that certain amounts be included in computing the income of a taxpayer for a taxation year. New paragraph 56(1)(aa) requires a taxpayer to include in computing income the value of workshops, seminars training programs and similar programs provided to any person in the year in respect of, in the course of, or by virtue of the taxpayer's membership in a registered national arts service organization. New paragraph 56(1)(aa) is applicable with respect to benefits received or enjoyed after July 13, 1990.

Subclause 32(8)

ITA
56(4.1) to (4.3)

Subsection 56(4.1) of the Act sets out an anti-avoidance rule that applies where an individual receives a loan, directly or indirectly, from another individual with whom the individual is not dealing at arm's length. Where one of the main reasons for making the loan was to avoid tax by having income included in the hands of the debtor, income derived from the loan is generally taxable in the hands of the creditor rather than the debtor.

Subsection 56(4.1) is amended to ensure that it applies not simply to loans but to all cases where an individual becomes indebted, directly or indirectly, to another individual with whom the individual is not dealing at arm's length. Thus, for example, the rule would apply where the unpaid balance of a purchase price is satisfied by a note bearing no interest or a low rate of interest where one of the main reasons for incurring the indebtedness was to avoid tax by having income included in the hands of the debtor. The amendments to subsections 56(4.2) and (4.3) are strictly consequential to these amendments.

Subsection 56(4.1) is also amended to ensure that it does not attribute income taxable in the hands of a trust to another individual where the trust has become indebted, directly or indirectly, to the other individual. At the same time, the subsection is amended to ensure that it applies in these circumstances where trust income has been flowed-through to a beneficiary with whom such other individual does not deal at arm's length.

Subsection 56(4.1) is also amended to ensure that, except as provided under new paragraph 56(4.1)(d), it does not apply to income that is attributed under subsection 75(2). The attribution of income to an individual (other than a trust) is now provided under new subparagraph 56(4.1)(c)(i).

Subsection 56(4.1) is also amended to ensure that it applies where an individual receives a loan from, or otherwise becomes indebted to, a trust. In these circumstances, assuming that the transaction is tax-motivated as set out in paragraph 56(4.1)(b) and property has been transferred to the trust by another individual with whom the debtor was not dealing at arm's length, any income of the debtor derived from the debt will generally be attributed to the trust inder new subparagraph 56(4.1)(c)(ii). The attribution of such income only applies in respect of periods during which the trust is resident in Canada and the debtor does not deal at arm's length with the transferor. In addition, the attribution of such income does not apply to the extent that it is otherwise attributed under new subparagraph 56(4.1)(c)(i), section 74.1 or subsection 75(2). However, under new paragraph 56(4.1)(d), income attributed under subparagraph 56(4.1)(c)(ii) to a trust may be further attributed by reason of subsection 75(2) to a contributor to the trust where subsection 75(2) applies in respect of the trust.

Finally, subsection 56(4.1) is amended so that it does not attribute income from an individual to his or her spouse in respect of periods throughout which the two individuals are living separate and apart by reason of a breakdown of their marriage.

These amendments are applicable to income relating to any periods commencing after 1990. Thus, for example, only dividends received or interest accruing after 1990 are subject to subsection 56(4.1) as amended.

The changes to subsections (4.2) and (4.3) are strictly consequential on the amendment to subsection (4.1).

Subclause 32(9)

ITA
56(7)

Subsections 56(5) to (7) of the Act deal with the taxation of family allowances. Paragraph 56(7)(a) provides that, where a taxpayer claims an equivalent-to-married credit in respect of a child for a particular year, the taxpayer is treated as the only individual to have supported the child in the year. This provision is intended to require that family allowances paid in respect of the child for each month of the year be included in the taxpayer's income for the year. However, this rule is deficient in the case of unmarried parents where one parent receives the family allowances for a particular child and the other parent claims the equivalent-to-married credit in respect of that child. This amendment, which applies to the 1988 and subsequent taxation years, corrects the unintended result by treating the claimant of the credit as having received the family allowances paid in respect of the dependent child.

Subclause 32(10)

ITA
56(8)

Currently, individuals receiving CPP/QPP disability pensions are taxed on the benefits in the year received, even though some portion of such benefits -- particularly the initial payment of disability benefits -- may relate to prior years. As a result, the tax payable on those benefits may be significantly higher than if the benefits had been paid and taxed on an ongoing basis from the date of eligibility. New subsection 56(8), which is applicable to amounts received after 1989, allows an individual to exclude from income in the year of receipt benefits that relate to prior years (except where the prior year benefits are less than $300) and thus to pay tax on those benefits as if they had been received in the prior years to which they relate. The payment of tax on this basis is provided for in new section 120.3 of the Act.

Subclause 32(11)

ITA
56(9)

Subsection 56(9) of the Act defines "income for the year" for the purpose of the rule that requires federal family allowance payments, social assistance payments and certain grants received by a married person or that person's spouse to be included in the income of the spouse having the higher income. The amendment to the subsection provides that "income for the year" for that purpose is income computed before the deduction of any unemployment insurance benefit repayment made pursuant to Part VII of the Unemployment Insurance Act. This amendment is applicable to the 1989 and subsequent taxation years.

Clause 33

Resource Property - Involuntary Dispositions

ITA
59.1

Section 59.1 of the Act allows a taxpayer to shelter gains realized in a taxation year from the expropriation under statutory authority of resource property with resource expenses incurred in the ten years immediately following the year. This special rule applies in respect of "property described in subsection 59(1.1), (1.2), or (3.1)". These subsections were repealed in 1985 and this amendment substituting the expression "Canadian resource property" is strictly consequential.

This amendment applies to amounts deemed to have become receivable in taxation years commencing after 1984.

Clause 34

Deductions in Computing Income

ITA
60

Section 60 of the Act provides for a number of deductions in computing income.

Subclause 34(1)

ITA
60(j)(ii)

Paragraph 60(j) of the Act permits a deduction in respect of certain transfers of superannuation benefits to registered pension plans and registered retirement savings plans. For the 1990 and subsequent taxation years, the deduction for a taxpayer under that paragraph is generally limited to lump sum payments from a pension plan (other than a registered pension plan) attributable to services rendered while the taxpayer was not resident in Canada.

Paragraph 60(j) is amended to extend this deduction where the taxpayer has received an eligible amount determined under new section 60.01. This new section includes a lump sum payment from a foreign retirement arrangement as an eligible amount where the payment is included in income pursuant to clause 56(1)(a)(i)(C.1) and derives from contribution made to the foreign retirement arrangement by the taxpayer or the taxpayer's spouse or former spouse. (For this purpose, "spouse" includes a common-law spouse as defined in subsection 146(1.1).)

These amendments are applicable in respect of payments received after July 13, 1990.

Subclause 34(2)

ITA
60(j.1)

Paragraph 60(j.1) of the Act provides that a taxpayer who receives a retiring allowance may deduct amounts contributed to a registered pension plan or a registered retirement savings plan (RRSP). The allowable deduction in respect of a retiree is generally based on the retiree's years of service with the employer who paid the retiring allowance in respect of the retiree or funded the retirement compensation arrangement under which the retiring allowance was paid. Where the retiree has vested pension benefits for each year of such service under a pension plan, the deduction is generally limited to $2,000 per year of such service. However, such service may also include the retiree's service with another employer related to the employer. The limit is intended to apply collectively in respect of all retiring allowances for a retiree from two or more related employers or under retirement compensation arrangements to which any of those employers contributed.

Clause 60(j.1)(ii)(C.1) is introduced to clarify that, where two or more related employers each pay a retiring allowance in the same year in respect of the service of the same retiree, the limits referred to above apply as intended in respect of those employers collectively.

Clause 60(j.1)(ii)(D) is amended to provide that a deductible return of a retiree's contributions from a retirement compensation arrangement will have the effect of reducing the limit under paragraph 60(j.1) in respect of the retiree's service with an employer only where the employer or a person related to that employer contributed to the retirement compensation arrangement.

Subparagraph 60(j.1)(iii) is amended to ensure that the deduction under subparagraph 60(j.1) is claimed by a taxpayer separately with respect to retiring allowances paid by each employer in the year.

The amendments to paragraph 60(j.1) may best be illustrated by way of an example.

<u>EXAMPLE</u>:

A is employed by X Co. and its subsidiary from 1982 to 1991. A receives retiring allowances in 1991 of $18,000 from X Co. and of $10,000 from the subsidiary. Assuming that X Co.'s pension contributions in respect of those years have fully vested in A at the time of the payment of the retiring allowances, how much of the retiring allowances may be transferred to A's RRSP under paragraph 60(j.1)?

1. The amendments ensure that the paragraph 60(j.1) deduction is claimed separately in respect of each employer, whether related or not.

2. A will decide in which order the paragraph 60(j.1) deductions will be claimed in respect of the two retiring allowances. The order chosen by A will not affect the total limit of $20,000. If A designates $18,000 under subparagraph 60(j.1) in respect of the retiring allowance paid by X Co., that amount may be transferred to the RRSP under paragraph 60(j.1) and be fully deducted because A cannot deduct more than $2,000 in respect of the retiring allowance paid by the subsidiary.

3. A then may determine the maximum amount in respect of the retiring allowance paid by the subsidiary. As A is deducting $18,000 in respect of the retiring allowance from X Co., new clause 60(j.1)(ii)(C.1) limits the allowable RRSP transfer under paragraph 60(j.1) to $2,000.

These amendments are applicable to the 1990 and subsequent taxation years. However, where a taxpayer so elects, the amendments will not apply to the taxpayer for the 1990 year and the total deduction available to the taxpayer under paragraph 60(j.1) for that year will be limited to the amount of retiring allowances paid to the taxpayer after 1989 and on or before July 13, 1990.

Subclause 34(3)

ITA
60(l)

Where a taxpayer has received a refund of RRSP premiums or certain other amounts, paragraph 60(l) of the Act provides a deduction for qualifying payments (not exceeding the amounts so received) made by the taxpayer to an RRSP or RRIF or to acquire a specified annuity. Paragraph 60(l) is amended so that an amount received by a taxpayer in a year from the Saskatchewan Pension Plan as a consequence of the death of the taxpayer's spouse or common-law spouse (as defined in proposed subsection 146(1.1)) will likewise permit the taxpayer to make a qualifying payment under paragraph 60(l).

This amendment applies to the 1990 and subsequent taxation years.

Subclause 34(4)

ITA
60(n)

An amendment to the Department of Labour Act, enabling the Minister of Labour to provide income assistance to eligible older workers under the Program for Older Worker Adjustment, received Royal Assent in June 1989. This consequential amendment to paragraph 60(n) of the Income Tax Act provides that a taxpayer who has received an overpayment of such income assistance payments may, where the overpayment was included in computing the taxpayer's income by reason of new subparagraph 56(1)(a)(vii), deduct the amount of any repayments in computing his income for the year in which those repayments were made.

Subclause 34(5)

ITA
60(o.1)

Paragraph 60(o.1) of the Act provides rules for the deduction of legal expenses by taxpayers in respect of retiring allowances and pension benefits. The French version of the paragraph is amended, effective for the 1986 and subsequent taxation years, to ensure that the English and French versions correspond in meaning.

Subclause 34(6)

ITA
60(v.1)

This amendment adds new paragraph 60(v.1) to the Act. Part VII of the Unemployment Insurance Act requires an individual who has received unemployment insurance benefits in a year and who has income for the year in excess of a stated limit to repay a portion of such benefits. The existing law provides that the amount repaid may be deducted in computing the individual's taxable income. New paragraph 60(v.1), together with the repeal of paragraph 110(1)(i) of the Act, provides that the amount repaid is deductible in computing income rather than taxable income. As a result of this change, the deduction will be taken into account in determining the individual's income for other purposes of the Act - such as the provisions requiring higher income individuals to repay all or part of old age security pensions and federal family allowance payments. New paragraph 60(v.1), and the repeal of paragraph 110(1)(i), are applicable to the 1989 and subsequent taxation years.

Clause 35

Eligible Amount

ITA
60.01

This amendment is discussed in the commentary on the amendment to subparagraph 60(j)(ii) of the Act.

Clause 36

Child Care Expenses

ITA
63

Section 63 of the Act provides rules governing the deductibility of child care expenses. The rules are amended to provide that, for the purposes of those rules, the income of an individual must be determined before deducting any unemployment insurance benefit repayment made pursuant to Part VII of the Unemployment Insurance Act. This amendment is applicable to the 1989 and subsequent taxation years.

Paragraph 63(3)(a) contains the definition "child care expenses" and excludes from that definition amounts paid to a related person under 21 years of age. The amendment to this definition reduces the minimum age of the related person from 21 to 18 years of age and is a relieving change made as a consequence of the general recognition of age 18 as the age of majority. This amendment is applicable to the 1990 and subsequent taxation years.

Subclause 63(1)(e)(ii)(A)(II), clause 63(2)(b)(i)(B) and subclause 63(3)(a)(iii)(A)(II) are also amended, applicable to the 1991 and subsequent taxation years, to reflect the changes made to sections 118.3 and 118.4 with respect to the disability tax credit.

Clause 37

Attendant Care Expenses

ITA
64

Section 64 of the Act provides a deduction of up to $5,000 in respect of attendant care expenses incurred by a disabled individual to enable the individual to work. The amendment to section 64, applicable to the 1989 and subsequent taxation years, clarifies that only unreimbursed expenses qualify for the deduction. In addition, the amendment extends the deduction where the expenses are paid after 1990 to a related person, other than the individual's spouse, who is at least 18 years of age.

Clause 38

Resource Properties

ITA
66

Section 66 of the Act provides various rules relating to Canadian and foreign resource properties.

Subclause 38(1)

ITA
66(5)

Subsection 66(5) of the Act provides that the special rules with respect to resource expenditures do not apply in computing the income of a taxpayer (other than a principal-business corporation) where the business of the taxpayer includes trading or dealing in rights to explore for, drill for, or take minerals, petroleum, natural gas or related hydrocarbons. Subsection 66(5) is amended as a consequence of the introduction of the new successor rules under section 66.7, to ensure that the successor rules do not apply to such dealers.

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

Subclause 38(2)

ITA
66(10.1)(b)

Subsection 66(10.1) of the Act allows a joint exploration corporation (JEC) to renounce a Canadian exploration expense (CEE) net of assistance related to the expense in favour of a shareholder corporation. The amount so renounced is treated as having been incurred by the shareholder corporation for the purposes paragraphs 66.1(6)(a) and (b), under which a taxpayer's CEE and cumulative CEE are determined.

A taxpayer's CEE includes "qualified Canadian exploration expenditures", as defined in section 4608 of the Income Tax Regulations. As a consequence, a JEC may renounce such an expenditure in favour of a shareholder corporation under subsection 66(10.1) and thereby allow the shareholder corporation to claim an investment tax credit under subsection 127(5).

Paragraph 66(10.1)(b) is amended so that the assistance reducing the amount that may be renounced by a JEC excludes investment tax credits to which its shareholder corporations are entitled as a result of incurring "qualified Canadian exploration expenditures". This avoids a problem of circularity since the amount of such investment tax credit and the amount that may be renounced would otherwise depend on each other. The amount of such an investment tax credit is recognized as a reduction in a shareholder corporation's cumulative Canadian exploration expense under paragraph 66.1(6)(b).

This amendment is applicable to assistance for expenses incurred after November 30, 1985.

Subclauses 38(3) to (5)

ITA
66(12.61), (12.63) and (12.65)

Subsections 66(12.6) to (12.65) of the Act provide for the renunciation by a corporation in favour of a flow-through shareholder of expenditures incurred by the corporation. Subsections 66(12.68), (12.69) and (12.7) require the filing by corporations and partnerships of documents in relation to a flow-through share offering and in relation to renunciations of expenses in respect of such an offering. Subsection 66(12.74) permits the late filing of the required documents for a period of 90 days, provided a specified penalty is paid.

Subsections 66(12.61), (12.63) and (12.65) are amended so that renunciations are effective only where the filing requirements in subsections 66(12.69) to (12.701) are met.

These amendments, applicable after July 13, 1990, are strictly consequential on the amendments to subsections 66(12.69) and (12.7) and the introduction of subsections 66(12.691) and (12.701), as described below.

Subclause 38(6)

ITA
66(12.69) to (12.701)

Subsection 66(12.69) of the Act requires that a partnership file an information return on or before the last day of the third month following the end of its fiscal period reporting allocations to partners of resource expenditures renounced to the partnership in the fiscal period. Subsection 66(12.69) is amended so that a partnership is treated as not having incurred such expenditures if this filing requirement is not met. Subsection 66(12.69) is also amended so that the document required to be filed is referred to as a prescribed form rather than an information return.

These amendments apply with respect to fiscal periods ending after July 13, 1990.

ITA
66(12.691)

Subsections 66.1(7), 66.2(6) and 66.4(6) of the Act provide for special rules which ensure that assistance which a partnership receives or becomes entitled to receive is attributable to members of the partnership. These rules do not contemplate circumstances where a partnership receives assistance as an agent on behalf of members, as is the case with assistance under the Canadian Exploration Incentive Program.

Subsection 66(12.691) is introduced to require a partnership to file a prescribed form reporting allocations of assistance to partners and former partners which it has received or become entitled to receive as an agent, where such assistance relates to resource expenditures incurred by a corporation or renounced under the flow-through shares rules to the partnership by the corporation. This prescribed form is generally required to be filed (with the prescribed form under subsection 66(12.69)) on or before the last day of the third month following the end of the fiscal period in which the entitlement to such assistance is first known. However, if the entitlement of members or former members to such assistance is first known at the end of a calendar year that precedes or follows the end of such fiscal period, the information return is required to be filed within three months of the end of such calendar year. If a partnership fails to file a prescribed form under subsection 66(12.691) on a timely basis, the partnership is deemed not to have incurred the expenditures to which such assistance relates unless the prescribed form is filed late under subsection 66(12.74).

This amendment applies in respect of assistance that a partnership receives or becomes entitled to receive after 1989 and in a fiscal period ending after July 13, 1990.

ITA
66(12.7)

Subsection 66(12.7) of the Act requires that a corporation file a prescribed form in respect of resource expenditures renounced by the corporation. The prescribed form is required to be filed by the end of the month following the month of the renunciation. Subsection 66(12.7) is amended so that a renunciation of expenditures by a corporation after July 13, 1990 will only be effective where the prescribed form under that subsection has been filed on a timely basis or is filed late under subsection 66(12.74).

ITA
66(12.701)

Subsection 66(12.701) of the Act is introduced to require a corporation to file a prescribed form showing allocations of assistance (e.g. payments under the Canadian Exploration Incentive Program) in respect of resource expenditures incurred by the corporation. This new provision applies where the assistance is held by the corporation as agent for holders of its flow-through shares. The prescribed form is required to be filed by the end of the month following the month in which the entitlement of shareholders or former shareholders is first known. As a consequence, such a prescribed form would generally be filed with the information required under subsection 66(12.7). If a corporation fails to file a prescribed form under subsection 66(12.701), it is deemed not to have incurred the expenditures to which such assistance relates unless the prescribed form is filed late under subsection 66(12.74).

This amendment applies in respect of assistance that a corporation receives or becomes entitled to receive after July 13, 1990.

Subclause 38(7)

ITA
66(12.72)

Subsection 66(12.72) of the Act permits the Minister of National Revenue to verify or ascertain information pertaining to Canadian resource expenditures that have been renounced by a corporation. This subsection is amended to ensure that the Minister may verify or ascertain information pertaining to assistance in respect of such expenditures. Subsection 66(12.72) is also amended by eliminating an unnecessary reference to the filing of an income tax return by such a corporation.

These amendments are applicable after July 13, 1990.

Subclause 38(8)

ITA
66(12.74)

Subsection 66(12.74) of the Act permits the late filing of documents for 90 days beyond the day the document is required to be filed, where a penalty specified in subsection 66(12.75) is paid on the late filing. Where the late filing of a document is permitted, the document is treated as having been filed on a timely basis.

Subsection 66(12.74) is amended to refer to all documents described in subsections 66(12.68) to (12.701). It is also amended to permit the late filing of those documents by a corporation or partnership beyond the 90-day late filing period in appropriate circumstances.

This amendment is applicable to documents filed after June 1988.

Subclause 38(9)

ITA
66(12.75)

Subsection 66(12.75) of the Act provides a penalty for the late filing of documents under subsection 66(12.74). The penalty is the lesser of $15,000 and 1/4 of 1% of the renounced or attributed expenses covered by the document.

Subsection 66(12.75) is amended to provide a penalty of 1/4 of 1% of assistance (to a maximum of $15,000) in relation to documents under which assistance is allocated under new subsections 66(12.691) and (12.701). This penalty applies only with respect to documents filed after Royal Assent. Where such a document is filed under subsection 66(12.74) after July 13, 1990 and on or before Royal Assent, the penalty so provided is nil.

Subsection 66(12.75) is also amended to provide a minimum penalty of $100 with respect to the filing of documents under subsection 66(12.74) after Royal Assent.

Subclause 38(10)

ITA
66(15)(d.1)

Paragraph 66(15)(d.1) of the Act provides the definition of "flow-through share" for the purposes of sections 66 to 66.2, 66.4 and 66.7. A flow-through share is generally a share of the capital stock of a principal-business corporation that is to be issued to a person pursuant to an agreement in writing under which the corporation agrees to incur resource expenditures and renounce those expenditures to that person. A "flow-through share" excludes a share prescribed under the Regulations pursuant to paragraph 66(15)(d.1).

Paragraph 66(15)(d.1) is amended so that the consideration for such an agreement may not include property to be exchanged or transferred in circumstances in which the special rollover rules in section 51, 85, 85.1, 86 or 87 apply. This amendment applies in respect of shares issued pursuant to an agreement in writing entered into after July 13, 1990.

Subclause 38(11)

ITA
66(16) and (17)

Subsection 66(16) of the Act provides that a partnership is deemed to be a person having a taxation year coinciding with its fiscal period. The rule applies for the purposes of the provisions under which resource expenditures are renounced in connection with flow-through share offerings.

Subsection 66(16) is amended so that it also applies for the purposes of new subsections 66(18) and (19). These new subsections, which relate to the attribution of resource expenditures to partnership members and the renunciation of resource expenditures by corporations, are discussed further below.

This amendment applies in respect of fiscal periods ending after February 1986.

ITA
66(17)

Under subsection 66(12.66) of the Act, certain Canadian exploration expenses incurred in the first 60 days of a calendar year may be treated as having been incurred at the end of the preceding calendar year for the purpose of the flow-through share rules. This rule does not apply where the flow-through share subscriber and the renouncing corporation do not deal with each other at arm's length. The purpose of this exception is to prevent the 60-day rule being used to accelerate deductions in non-arm's length groups. Subsection 66(17) defines circumstances in which a non-arm's length relationship between a partnership and a renouncing corporation is considered to exist for the purposes of the 60-day rule.

Subsection 66(17) is amended to provide that, for the purposes of the 60-day rule, the determination of whether a renouncing corporation and a partnership deal at arm's length is based exclusively on whether a share of Canadian exploration expense renounced in favour of the partnership by the corporation is included, by reason of subparagraph 66.1(6)(a)(iv), in the Canadian exploration expense of the corporation (where the corporation is a member of the partnership) or of a member of the partnership with whom the corporation does not deal at arm's length. The amendment thus allows the 60-day rule to be effective in respect of a partnership unless the rule would otherwise result in an acceleration of the claim of expenditures by the renouncing corporation or a person not dealing at arm's length with the renouncing corporation.

This amendment is applicable with respect to fiscal periods ending after February 1986.

Subclause 38(12)

ITA
66(18) and (19)

New subsection 66(18) of the Act is introduced to clarify the tax treatment of a person (including a partnership) who is a member of a partnership involved in mining or oil and gas. Where a resource expenditure is attributed by the partnership to the person, the person is treated under this provision as having incurred the attributed expenditure at the end of the fiscal period in which that expenditure is incurred by the partnership to the extent that such attributed expenditure is included in the person's foreign exploration and development expense (FEDE), Canadian exploration expense (CEE), Canadian development expense (CDE) or Canadian oil and gas property expense (COGPE). The new rule applies for the purposes of subsection 21(2) and sections 59.1 and 66 to 66.7, except for the purposes of applying the provisions therein defining FEDE, CEE, CDE or COGPE in respect of the taxpayer. These latter provisions already make specific reference to a taxpayer's share of a partnership's resource expenditures.

The new rule also applies for the purposes of the cumulative net investment loss (CNIL) provisions. This is appropriate because the CNIL of an individual, which reduces the capital gains exemption available to the individual under section 110.6, includes 50% of resource expenditures incurred and renounced under the flow-through share rules by a corporation to the individual. The new rule would be relevant in this regard only where the renouncing corporation is a member of a partnership.

As a consequence of subsection 66(18), it is clear that a taxpayer's share of a partnership's FEDE, CEE, CDE and COGPE is included in the cumulative pools to which those expenditures relate. The new rule also ensures that a taxpayer would not be precluded from renouncing such expenditures under any of subsections 66(10.1) to (10.3), (12.6), (12.62) or (12.64), subject to the new rule in subsection 66(19).

This amendment is applicable in respect of fiscal periods ending after February 1986.

ITA
66(19)

The flow-through share rules are intended to encourage new resource expenditures by permitting such expenditures by corporations to be renounced in favour of investors who are better able to take advantage of the related deductions.

Subsections 66(12.6), (12.62) and (12.64) provides that only expenditures incurred after the relevant flow-through share agreement is entered into may be renounced by a corporation. However, where a corporation is a member of a partnership or is a corporation in favour of which a resource expenditure of another corporation is renounced under subsection 66(12.6), (12.62) or (12.64), the rules in the Act generally delay the time at which renounced or partnership expenditures are considered to be incurred by the corporation. As a consequence, subsections 66(12.6), (12.62) and (12.64) may allow for the renunciation of expenditures originally incurred before the relevant flow-through share agreement was entered into.

Subsection 66(19) is introduced to limit renunciations by corporations under subsection 66(12.6), (12.62) and (12.64) to those that would have been effective had the Act provided for no delay in the time at which a member of a partnership or a flow-through share subscriber is considered to incur the resource expenditures of the partnership or the flow-through share corporation. The rule thus prevents the "warehousing" of resource expenditures originally incurred before a flow-through share agreement is entered into for renunciation after the agreement is entered into.

Subsections 66(18) and (19) are also intended to apply to tiers of partnerships and flow-through share corporations. For example, the following results would be obtained where corporation A is a member of Partnership X which is a member of Partnership Y, the at-risk rules in section 66.8 do not apply and Y incurs resource expenditures in a fiscal period:

- X's share of those expenditures in respect of Y's fiscal period are considered to have been incurred by X at a particular time that coincides with the end of that fiscal period;

- Corporation A's share of the expenditures considered to have been incurred by X are considered to be incurred by corporation A at the end of the first fiscal period of X ending at or after the particular time; and

- Corporation A would only be entitled to renounce its share of X's expenditures in favour of a flow-through share subscriber if it would have been entitled to renounce that amount to the subscriber if its share of partnership expenditures were attributed to it as of the time that Y incurred such expenditures.

The introduction of subsection 66(19) is effective in respect of renunciations of expenditures incurred after July 13, 1990, other than such expenditures incurred pursuant to an agreement in writing entered into on or before that date.

Clause 39

Canadian Exploration Expense

ITA
66.1

Section 66.1 of the Act provides the rules relating to the deduction of "Canadian exploration expense" as defined in paragraph 66.1(6)(a).

Subclauses 39(1) to (4)

ITA
66.1(1) to (3) and (6)

Subsections 66.1(2) and (3) of the Act allow a taxpayer a deduction with respect to its cumulative Canadian exploration expense (cumulative CEE) at the end of a year, as determined under paragraph 66.1(6)(b). Subsection 66.1(1) provides, in conjunction with paragraph 59(3.2)(b), for the inclusion in a taxpayer's income for the year of any negative cumulative CEE balance of the taxpayer. Subsections 66.1(1) to (3) and (6) are amended, as described further below, to ensure that a vendor may take advantage of its cumulative CEE in a year of succession irrespective of post-succession adjustments to cumulative CEE.

The amendments to subsections 66.1(1) to (3) and subparagraph 66.1(6)(b)(iv.2) are intended to recognize the effect of the successor rules on cumulative CEE under subsection 66.7(12). The latter subsection provides for a reduction of cumulative CEE immediately after the time that is immediately after the succession where a taxpayer has transferred its properties pursuant to the successor rules under section 66.7. This reduction is equal to the amount by which its cumulative CEE remaining immediately after the succession exceeds its claim in respect of cumulative CEE at the end of the year. However, as such claim in respect of cumulative CEE depends on the reduction of cumulative CEE, section 66.1 and paragraph 66.7(12)(b) operate in a circular manner. This leads to an unintended result in the case of a taxpayer whose cumulative CEE is reduced in a taxation year after a succession in the year (for example, by the receipt of an amount of assistance in excess of CEE incurred after the succession). Such a taxpayer would not be able to claim any amount for the year as a deduction in respect of cumulative CEE and would have an income inclusion under subsection 66.1(1) for the year equal to such a reduction in cumulative CEE.

Subsection 66.1(1) is amended so that, where a taxpayer disposes of property in a year in circumstances in which the successor rules apply, the taxpayer is generally required to use the cumulative CEE remaining immediately after the succession to reduce the amount otherwise required to be included in the taxpayer's income under subsection 66.1(1) for the year. This amendment applies only in the case, referred to above, where a taxpayer further reduces its cumulative CEE after a succession and in the year of the succession. It does not apply to the extent that the taxpayer designates such cumulative CEE in favour of a successor under new clause 66.7(12.1)(a)(i)(B).

Subsections 66.1(2) and (3) are amended so that where a taxpayer disposes of property in a taxation year in circumstances in which the successor rules apply, the taxpayer may use the cumulative CEE remaining immediately after the succession (net of any such amount used to prevent an income inclusion for the year under subsection 66.1(1) or designated in favour of a successor under new clause 66.7(12.1)(a)(i)(B)) as a basis for a deduction under subsection 66.1(2) or (3) for the year. (By virtue of amended paragraph 66.7(12)(b), the taxpayer would otherwise not be able to use any such pre-succession cumulative CEE.)

Subparagraph 66.1(6)(b)(iv.2) is introduced to provide that the amount of the cumulative CEE remaining immediately after the succession that is used by a taxpayer in the year of succession (either as a deduction under subsection 66.1(2) or (3) or to prevent an income inclusion by virtue of subsection 66.1(1)) is added to the taxpayer's cumulative CEE immediately after the year of succession. By virtue of the interaction of this new provision with subparagraphs 66.1(6)(b)(v) and (xii), a taxpayer will have a nil balance of cumulative CEE after the year of a succession in the typical case where no post-succession CEE is incurred in that year. This is illustrated in the example contained in the commentary to subsections 66.7(12) and (12.1).

These amendments are applicable to taxation years ending after February 17, 1987 except that paragraph 66.1(6)(b) is amended only with respect to taxation years commencing after February 17, 1987. However, the amendments are structured so that they will not have any effect unless the amendments to subsections 66.7(12) and (12.1) are also effective. A special transitional rule detailed in the commentary on those subsections makes subsections 66.7(12) and (12.1) apply to taxation years ending after February 17, 1987 only where the appropriate election is filed with the Minister of National Revenue. Where no election is filed, the amendments to subsections 66.7(12) and (12.1) are effective in respect of taxation years commencing on or after Royal Assent.

Subclause 39(5)

ITA
66.1(7)

Subsections 66.1(7), 66.2(6) and 66.4(7) of the Act provide for the allocation to members of a partnership of assistance and certain other amounts receivable by the partnership in a fiscal period. The member's share of such an amount is generally recognized as a reduction in the member's cumulative Canadian exploration expense (CEE), cumulative Canadian development expense (CDE) or cumulative Canadian oil and gas property expense (COGPE) for the taxation year of the member in which the partnership's fiscal period ends. The recognition of such amounts is accelerated under subsection 66.2(7) or 66.4(7) in the special case where the partnership is deemed to have disposed of property under subsection 115(4).

Subsections 66.1(7), 66.2(6), 66.2(7), 66.4(6) and 66.4(7) are amended so that repayments of assistance by a partnership are allocated to members of the partnership on the same basis as payments of such assistance. The repayment of such assistance is now explicitly recognized through the increase in the taxpayer's cumulative CEE, CDE or COGPE under new subparagraph 66.1(6)(b)(iv.1), 66.2(5)(b)(iii.1) or 66.4(5)(b)(iii.1). These amendments are applicable after January 1990.

Subsection 66.4(7) is also amended so that it applies in respect of the disposition of "Canadian resource property" rather than "property described in any of paragraphs 59(1.2)(a), 59(2)(c) or (d)". This amendment is strictly consequential to the repeal of subsections 59(1.2) and (2) in 1985 and the extension at the same time of the definition "Canadian resource property". This amendment is applicable with respect to taxation years commencing after 1984.

Clause 40

Canadian Development Expense

ITA
66.2

Section 66.2 of the Act provides rules relating to the deduction of "Canadian development expense" as defined in paragraph 66.2(5)(a). The amendments to this section parallel those made to section 66.1 relating to Canadian exploration expenses.

Subclauses 40(1) to (3)

ITA
66.2(1), (2) and (5)(b)(iii.2)

Subsection 66.2(2) of the Act allows a taxpayer a deduction for a taxation year in respect of its cumulative Canadian development expense (cumulative CDE) at the end of year, as determined under paragraph 66.2(5)(b). Subsection 66.2(1) requires a taxpayer, in conjunction with paragraph 59(3.2)(c), to include in computing income for a taxation year any negative balance of the taxpayer's cumulative CDE at the end of the year. Subsections 66.2(1), (2) and (5) are amended, as described further below, to allow a vendor to take advantage of its cumulative CDE in a year of succession.

The amendments to subsections 66.2(1) and (2) and subparagraph 66.2(5)(b)(iii.2) are intended to recognize the effect of the successor rules on cumulative CDE under subsection 66.7(12). Where a taxpayer disposes of properties in a succession under 66.7, the taxpayer's cumulative CDE is reduced immediately after the time that is immediately after the succession to nil under paragraph 66.7(12)(c). Where the taxpayer disposes of oil and gas properties in the succession, any negative cumulative Canadian oil and gas property expense (cumulative COGPE) resulting from the succession further reduces cumulative CDE at the end of the year under subparagraph 66.2(5)(b)(x) and is brought into income in the typical case where a taxpayer incurs no further CDE after a succession.

Subsection 66.2(1) is amended so that, where a taxpayer disposes of property in a taxation year in circumstances in which the successor rules apply, the taxpayer is required to use the cumulative CDE remaining immediately after the succession to reduce the amount otherwise required to be included in the taxpayer's income under 66.2(1) for the year. This amendment would most typically be relevant on the application of subparagraph 66.2(5)(b)(x), as described above. It does not apply to the extent such cumulative CDE is designated in favour of a successor under new clause 66.7(12.1)(b)(i)(B).

Subsection 66.2(2) is amended so that, where a taxpayer disposes of property in a taxation year in circumstances in which the successor rules apply, the taxpayer may use the cumulative CDE remaining immediately after the succession (net of any such amount used to prevent an income inclusion for the year under subsection 66.2(1) or designated in favour of a successor under new clause 66.7(12.1)(b)(i)(B)) as a basis for a deduction under subsection 66.2(2) for the year. A related amendment to subsection 66.7(4) generally provides that a successor is not allowed to claim any amount in its first taxation year following the succession in respect of such cumulative CDE of a taxpayer, where the successor and the taxpayer did not deal at arm's length at the time of the succession.

Subparagraph 66.2(5)(b)(iii.2) is introduced to provide that the amount of the cumulative CDE remaining immediately after the succession that is used by a taxpayer in the year of succession (either as a deduction under subsection 66.2(2) or to prevent an income inclusion under subsection 66.2(1)) is added to the taxpayer's cumulative CDE immediately after the year of succession. By virtue of the interaction of this new provision with subparagraphs 66.2(5)(b)(iv) and (xiii), a taxpayer will have a nil balance of cumulative CDE immediately after the year of a succession in the typical case where no post-succession CDE is incurred in that year. This is illustrated in the example contained in the commentary to subsections 66.7(12) and (12.1).

These amendments are applicable to taxation years ending after February 17, 1987 except that paragraph 66.2(5)(b) is amended only with respect to taxation years commencing after February 17, 1987. However, the amendments are structured so that they will not have any effect unless the amendments to subsections 66.7(12) and (12.1) are also effective. A special transitional rule detailed in the commentary on those subsections makes subsections 66.7(12) and (12.1) apply to taxation years ending after February 17, 1987 only where the appropriate election is filed with the Minister of National Revenue. Where no election is filed, the amendments to subsections 66.7(12) and (12.1) are effective in respect of taxation years commencing on or after Royal Assent.

Subclause 40(4)

ITA
66.2(6) and (7)

The amendments to subsections 66.2(6) and (7) of the Act are discussed in the commentary on the amendment to subsection 66.1(7).

Clause 41

Canadian Oil and Gas Property Expense

ITA
66.4

Section 66.4 of the Act provides rules relating to the deduction of "Canadian oil and gas property expense" as defined in paragraph 66.4(5)(a). The amendments to this section parallel those made to sections 66.1 and 66.2 relating to Canadian exploration expenses and Canadian development expenses.

Subclauses 41(1) to (3)

ITA
66.4(1), (2) and (5)(b)(iii.2)

Subsection 66.4(2) of the Act allows a taxpayer a deduction for a taxation year in respect of its cumulative Canadian oil and gas property expense (cumulative COGPE) at the end of the year, as determined under paragraph 66.4(5)(b). Subsection 66.4(1), in conjunction with subparagraph 66.2(5)(b)(x), requires any negative balance in a taxpayer's cumulative COGPE at the end of a taxation year to reduce the taxpayer's cumulative Canadian development expense (cumulative CDE). The reduction in cumulative CDE will result in an income inclusion for the taxpayer by virtue of subsection 66.2(1) and paragraph 59(3.2)(c) if a negative cumulative CDE balance arises.

Subsection 66.4(1) is amended so that, where a taxpayer disposes of property in a taxation year in circumstances in which the successor rules under section 66.7 apply, the taxpayer is required to use the cumulative COGPE remaining immediately after the succession to reduce the amount which would otherwise reduce the taxpayer's cumulative CDE for the year. The amendment to subsection 66.4(1) is relevant only where, after a succession and in the taxation year of the succession, a taxpayer further reduces its cumulative COGPE (for example, by selling oil and gas properties which remain after the succession). The amendment does not apply to the extent that such cumulative COGPE is designated in favour of a successor under new clause 66.7(12.1)(c)(i)(B).

Subsection 66.4(2) is amended so that, where in a taxation year a taxpayer disposes of property in circumstances in which the successor rules apply, the taxpayer may use any pre-succession cumulative COGPE remaining immediately after the succession (net of any such amount used to prevent a reduction of cumulative CDE for the year under subsection 66.4(1) or designated in favour of a successor under new clause 66.7(12.1)(c)(i)(B)) as a basis for a deduction under subsection 66.4(2) in the year. A related amendment to subsection 66.7(5) generally provides that a successor is not allowed to claim any amount in its first taxation year following the succession in respect of such cumulative COGPE of a taxpayer, where the successor and the taxpayer did not deal at arm's length at the time of the succession.

Subparagraph 66.4(5)(b)(iii.2) is introduced to provide that the amount of cumulative COGPE remaining immediately after a succession that is used by a taxpayer in the year of the succession (either as a deduction under subsection 66.4(2) or to prevent a reduction of cumulative CDE by virtue of the application of subsection 66.4(1)) is added to the taxpayer's cumulative COGPE immediately after the year of succession. By virtue of the interaction of this new provision with subparagraphs 66.4(5)(b)(iv) and (ix), the taxpayer will have a nil balance of cumulative COGPE immediately after the year of succession in the typical case where no post-succession COGPE is incurred in the year.

These amendments are applicable to taxation years ending after February 17, 1987 except that paragraph 66.4(5)(b) is amended only with respect to taxation years commencing after February 17, 1987. However, the amendments are structured so that they will not have any effect unless the amendments to subsections 66.7(12) and (12.1) are also effective. A special transitional rule detailed in the commentary on those subsections makes subsections 66.7(12) and (12.1) apply to taxation years ending after February 17, 1987 only where the appropriate election is filed with the Minister of National Revenue. Where no election is filed, the amendments to subsections 66.7(12) and (12.1) are effective in respect of taxation years commencing on or after Royal Assent.

Subclause 41(4) and (5)

ITA
66.4(6) and (7)

These amendments are discussed in the commentary on the amendment on subsection 66.1(7) of the Act.

Clause 42

Successor Rules

ITA
66.7

Section 66.7 of the Act provides rules relating to the deduction, by a "successor corporation", of unused resource expenses of another person in respect of resource properties acquired by the successor corporation.

Subclauses 42(1) and (2)

ITA
66.7(1) and (2)

Subsections 66.7(1) and (2) of the Act provide successor deductions for corporations in respect of Canadian exploration and development expenses and foreign exploration and development expenses incurred by other taxpayers. These subsections are amended, applicable to taxation years ending after February 17, 1987, to ensure that a successor may claim no more as a deduction in this respect than the unused portions of such expenses.

Subsection 66.7(2) of the Act provides a successor deduction for corporations in respect of foreign exploration and development expenses (FEDE) incurred by other taxpayers. The successor deduction in respect of FEDE is limited to income from the disposition or production of foreign resource property acquired by the successor in a transaction to which the successor rules apply. However, a corporation to which the successor rules apply because it has undergone a change of control may elect under paragraph 66.7(10)(f) that an amount of income related to production from Canadian resource property owned by it prior to the change in control be treated as foreign resource income rather than Canadian resource income for the purposes of the application of the successor rules. The amount that may be so elected is limited so that the election will result in no more than a 10% write-off of the pool of unused successored FEDE. This is consistent with the FEDE rules in subsection 66(4) that allow for a minimum 10% write-off of FEDE.

Subsection 66.7(2) is amended so that the special election now provided under paragraph 66.7(10)(f) will also be available in respect of income attributable to production after 1988 where the successor rules apply in respect of asset acquisitions, including second and subsequent successions. As a consequence of the broader application of the election, paragraph 66.7(10)(f) is repealed and replaced with amendments to the portion of subsection 66.7(2) following paragraph (a) thereof. As a consequence of the repeal of paragraph 66.7(10)(f), the reference to that paragraph in paragraph 66.7(10)(h) is also eliminated.

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

Subclause 42(3)

ITA
66.7(3)

Subsection 66.7(3) of the Act provides successor deductions for corporations in respect of Canadian exploration expense incurred by other taxpayers. Paragraph 66.7(3)(a) is amended to ensure that a successor may claim no more as a deduction in this respect than the unused portion of such expense. This amendment is applicable to taxation years ending after February 17, 1987.

Subclause 42(4) and (5)

ITA
66.7(4)

Subsection 66.7(4) of the Act provides successor deductions for corporations in respect of Canadian development expense (CDE) incurred by other taxpayers. Paragraph 66.7(4)(a) is amended to ensure that a successor may claim no more as a deduction in this respect than the unused portion of such expense. This amendment is applicable to taxation years ending after February 17, 1987.

Paragraph 66.7(4)(b) is also amended to deny a corporation any successor deduction thereunder in respect of an original owner for the taxation year in which it acquired Canadian resource property from the original owner where the corporation and the original owner did not deal with each other at arm's length at the time of such acquisition. In addition, the amendment does not apply where the successor acquired the property by way of an amalgamation or merger or by virtue of the application of paragraph 66.7(10)(c). This amendment is related to the amendments to section 66.2 and subsections 66.7(12) and (12.1) under which an original owner is entitled to take advantage of its pre-succession cumulative CDE in the year of a succession. The intent of this amendment and a related amendment to subsection 66.7(14) is to prevent non-arm's length successions from being used as a means by which the deduction of cumulative CDE may be accelerated because of the parties involved being entitled to deduct cumulative CDE in respect of taxation years which coincide or overlap.

The amendment to paragraph 66.7(4)(b) is effective with respect to acquisitions from original owners in taxation years of original owners commencing on or after Royal Assent. However, where the election described in the commentary to subsections 66.7(12) and (12.1) is made, the amendment is applicable to acquisitions from original owners in taxation years of original owners ending after February 17, 1987.

Subclauses 42(6) and (7)

ITA
66.7(5)

Subsection 66.7(5) of the Act provides a successor deduction for corporations in respect of Canadian oil and gas property expense (COGPE) incurred by other taxpayers. Paragraph 66.7(5)(a) is amended to ensure that a successor may claim no more as a deduction in this respect than the unused portion of such expense. This amendment is applicable to taxation years ending after February 17, 1987.

Paragraph 66.7(5)(b) is also amended to deny a corporation any successor deduction thereunder in respect of an original owner for the taxation year in which it acquired Canadian resource property from the original owner where the corporation and the original owner did not deal with each other at arm's length at the time of such acquisition. In addition, the amendment does not apply where the successor acquired the property by way of an amalgamation or merger or by virtue of the application of paragraph 66.7(10)(c). This amendment is related to the amendments to section 66.4 and subsections 66.7(12) and (12.1) under which an original owner is entitled to take advantage of its pre-succession cumulative COGPE in the year of a succession. The intent of this amendment and a related amendment to subsection 66.7(14) is to prevent non-arm's length successions from being used as a means by which the deduction of cumulative COGPE may be accelerated because of the parties involved being entitled to deduct cumulative COGPE in respect of taxation years which coincide or overlap.

The amendment to paragraph 66.7(5)(b) is effective with respect to acquisitions from original owners in taxation years of original owners commencing on or after Royal Assent. However, where the election described in the commentary to subsections 66.7(12) and (12.1) is made, the amendment is applicable to acquisitions from original owners in taxation years of original owners ending after February 17, 1987.

Subclauses 42(8) to (10)

ITA
66.7(10)

Under subsection 66.7(10) of the Act, a corporation is treated as a successor for the purposes of the successor rules in section 66.7 after a change of control or tax-exempt status. Paragraphs 66.7(10)(f) to (j) provide for a number of special rules in these circumstances.

As a consequence of the amendment to paragraph 66.7(2)(b), paragraph 66.7(10)(f) is repealed and a cross-reference to that paragraph in 66.7(10)(h) is eliminated. For further detail, see the commentary on the amendments to subsection 66.7(2).

As a consequence of the amendments to paragraphs 66.7(4)(b) and (5)(b), clauses 66.7(4)(b)(i)(B) and (5)(b)(i)(B) become subclauses 66.7(4)(b)(i)(A)(II) and (5)(b)(i)(A)(II), respectively. The cross-reference to those clauses in paragraph 66.7(10)(j) is amended accordingly. For further detail, see the commentary on the amendments to subsections 66.7(4) and (5).

These amendments are applicable to taxation years ending after February 17, 1987.

Subclauses 42(11) to (15)

ITA
66.7(12) and (12.1)

Subsection 66.7(12) of the Act provides rules to determine an original owner's resource expenditure pools after the disposition of resource properties to a successor corporation in circumstances in which the successor rules apply. The existing rules generally require reductions in such accounts of the original owner so that it may not subsequent to the year of a succession take advantage of the portion of such pools created prior to the succession. In the case of the deduction in respect of cumulative Canadian development expense (cumulative CDE) and cumulative Canadian oil and gas property expense (cumulative COGPE), the existing rules also prevent the original owner from taking advantage of the pre-succession expenses in the year of succession. The special restrictions with respect to cumulative CDE and COGPE are intended to prevent the acceleration of deductions in respect of cumulative CDE and COGPE that could otherwise occur if an original owner and a successor could both claim a portion of those pools in their respective taxation years that include the time of succession.

Paragraph 66.7(12)(b) is amended so that the cumulative CEE balance of an original owner is required to be reduced to nil immediately after the time that is immediately after a succession in a taxation year. However, amendments to subsections 66.1(2) and (3) ensure that pre-succession cumulative CEE may continue to be deducted by an original owner in the year of succession. (In addition, amended subsection 66.1(1) generally requires pre-succession cumulative CEE to reduce the amount otherwise included in computing income in the year of succession under paragraph 59(3.2)(b) as a consequence of the original owner having a negative cumulative CEE balance at the end of the year of succession.) For further detail, see the commentary on the amendments to subsections 66.1(1), (2), (3) and (6).

New paragraph 66.7(12)(b.1), in conjunction with paragraph 66.7(12.1)(a), provides that the amount of cumulative CEE used by any original owner is considered to be used by the original owner on a "first-in, first-out" basis for the purposes of determining the cumulative CEE pool available to a successor. Even where the original owner incurs significant post-succession expenditures in the year of succession, the original owner's cumulative CEE pool available to the successor would generally be required to be reduced by the claim for CEE made by the original owner in the year of succession. However, the original owner is permitted under clause 66.7(12.1)(a)(i)(B) to designate all or part of its pre-succession CEE in favour of a successor by filing a prescribed form with Revenue Canada within 6 months after the year of succession. In these circumstances, the original owner's CEE claim for the year would not reduce the amount so designated for the benefit of the successor.

New paragraph 66.7(12)(b.2) is introduced to ensure that, after the year of succession, the original owner is considered to deduct no amount in respect of pre-succession cumulative CEE.

Subsection 66.7(12) is also amended to provide, in conjunction with new paragraph 66.7(12.1)(a), rules in the event that the original owner has more than one succession in the year to which the successor rules under section 66.7 apply. Where cumulative CEE is used by the original owner in the succession year (either as a deduction under subsection 66.1(2) or (3) or to prevent an income inclusion under paragraph 59(3.2)(b)), new paragraph 66.7(12)(b.1) ensures that the amount so used is required to reduce the cumulative CEE available to the successor. In the event there is more than one succession by the original owner in a year, the amount of cumulative CEE so used is applied first to reduce the successored CEE pool arising from the first succession in the year and the remainder is applied in respect of other successions in the year in the order of their occurrence. Note, however, that an amount designated by the original owner under clause 66.7(12.1)(a)(i)(B) in respect of a disposition to a successor would be excluded from the cumulative CEE which could be used by the original owner.

New paragraphs 66.7(12)(c.1), (c.2), (d.1) and (d.2), in conjunction with new paragraphs 66.7(12.1)(b) and (c), ensure that the appropriate amount of an original owner's cumulative CDE and COGPE are available to a successor. These new paragraphs operate in the same manner as the rules described above with respect to cumulative CEE.

The application of amended subsection 66.7(12) and new subsection 66.7(12.1), in conjunction with the amendments to sections 66.1 and 66.2, is illustrated below.

EXAMPLE

V is the original owner of oil and gas properties substantially all of which are sold to Corporation A immediately before midnight on May 1, 1992 in circumstances in which the successor rules apply. V sells its remaining oil and gas properties to Corporation B immediately before midnight on December 1, 1992 in circumstances to which the successor rules apply. The sales of the properties result in a reduction of cumulative CDE under subparagraph 66.2(5)(b)(x) of $6,500 at the end of the year. V also becomes entitled to assistance of $600 in respect of its CEE at the end of the year. Assume the cumulative CEE and CDE of V, determined at the relevant dates without regard to the application of subsection 66.7(12) in respect of the year, are as follows:

	May 2	Dec. 2	Dec. 31
cumulative CEE	1,000	2,400	1,800
cumulative CDE	5,000	9,000	2,500

How do the amended successor rules apply to V, A and B, assuming that V operates for tax purposes on a calendar year basis and does not make any designation under clauses 66.7(12.1)(a)(i)(B) or (b)(i)(B)?

Cumulative CEE

(1) By virtue of paragraph 66.1(1)(c), V is required to use part of the total of $2,400 of cumulative CEE otherwise available to A and B to prevent an income inclusion of $600 under subsection 66.1(1) for the 1992 year and may use any portion of the remaining $1,800 as a claim under subsection 66.1(2) or (3) for the year. V claims $150 and therefore uses a total of $750 ($150 + $600) of its cumulative CEE. At the beginning of the 1993 taxation year, V's cumulative CEE is nil, computed as follows:

unadjusted cumulative CEE at end of 1992 year	$1,800
adjustments under paragraph 66.7(12)(b)	
- May 2, 1992	(1,000)
- Dec. 2, 1992	(1,400)
adjustment under subparagraph 66.1(6)(b)(v) at beginning of 1993 year	(150)
adjustment under subparagraph 66.1(6)(b)(iv.2) at beginning of 1993 year	750
	nil

(2) The $750 of cumulative CEE so used by V is applied to reduce the successored cumulative CEE available to A from $1,000 to $250. The successored cumulative CEE available to B (reduced by $1,000 on May 2 under paragraph 66.7(12)(b) to reflect the first succession in the year) is $1,400.

Cumulative CDE

(1) By virtue of paragraph 66.2(1)(d), V is required to use part of the total of $9,000 of cumulative CDE otherwise available for A and B to prevent an income inclusion of $6,500 under subsection 66.2(1) for the 1992 year and

may use any portion of the remaining $2,500 as a claim under subsection 66.2(2) for the year. V claims $750 (30% X $2,500) under subsection 66.2(2) and therefore uses a total of $7,250 ($6,500 + $750) of its cumulative CDE. At the beginning of the 1993 year V's cumulative CDE is nil, computed as follows:

unadjusted cumulative CDE at end of 1992 year	$2,500
adjustments under paragraph 66.7(12)(c)	
- May 2, 1992	(5,000)
- Dec. 2, 1992	(4,000)
adjustment under subparagraph 66.2(5)(b)(iv) at beginning of 1993 year	(750)
adjustment under subparagraph 66.2(5)(b)(iii.2) at beginning of 1993 year	7,250
	nil

(2) The $7,250 of cumulative CDE so used by V is applied first to reduce the successored cumulative CDE from available to A from $5,000 to nil. The remaining $2,250 reduces the successored cumulative CDE available to B (already reduced by $5,000 on May 2 under paragraph 66.7(12)(c) to reflect the first succession in the year) from $4,000 to $1,750.

The amendments are applicable in respect of dispositions in a taxation year commencing on or after Royal Assent. However, these amendments also apply on the filing of an election in respect of dispositions by an original owner of Canadian resource property in a taxation year ending after February 17, 1987. The election must be filed not later than 180 days after the end of the original owner's taxation year that includes the date of Royal Assent by the original owner and each corporation which became a successor to the original owner before the end of the original owner's taxation year that includes the date of Royal Assent.

Where such an election is made, a designation under clause 66.7(12.1)(a)(i)(B), (b)(i)(B) or (c)(i)(B) may be filed at the same time.

Subclause 42(16)

ITA
66.7(14)

Subsection 66.7(14) of the Act provides that, where a successor corporation in respect of an original owner subsequently disposes of Canadian resource property in a taxation year to a subsequent successor corporation in circumstances to which section 66.7 applies, the first-mentioned successor corporation is generally not entitled to claim successor deductions for the year or subsequent years in respect of resource expenditures incurred by the original owner. However, an exception to this rule allows the corporation to claim such a successor deduction for the year of the succession in respect of Canadian exploration and development expenses and Canadian exploration expense incurred by the original owner.

Subsection 66.7(14) is amended to allow a successor corporation to claim a successor deduction for the year of a subsequent succession in respect of Canadian development expense (CDE) and Canadian oil and gas property expense (COGPE). This is consistent with the amendments to sections 66.2 and 66.4 and subsection 66.7(12) which are discussed above. However, this new provision will not apply where the parties to the disposition do not deal at arm's length except where the disposition was made by way of an amalgamation or merger. The purpose of this restriction and related amendments to subsections 66.7(4) and (5) is to prevent non-arm's length successions from being used as a means by which the deduction of cumulative CDE or COGPE may be accelerated.

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

Clause 43

Entertainment Expenses

ITA
67.1(2)(e)

Paragraph 67.1(2)(e) of the Act provides an exemption from the restriction on the deductibility of food, beverages and entertainment expenses where an amount in respect of such expenses is incurred to provide food, beverages or entertainment to all employees at a particular location. This paragraph is intended to exclude from the application of subsection 67.1(2) costs incurred in respect of events to which all employees at a particular location have access, such as a firm party.

This paragraph is amended to clarify that, for this exemption to apply, the food, beverages or entertainment must be generally available to all employees at a particular location of the employer and consumed or enjoyed by such employees.

This amendment is applicable to taxation years ending after July 13, 1990.

Clauses 44 and 45

Passenger Vehicles

ITA
67.2

Section 67.2 of the Act contains restrictions on the amount that may be deducted in respect of interest expense relating to the acquisition of a passenger vehicle. The amount of interest is deemed to be the lesser of the actual amount payable and the amount as determined by a formula. While the reference to "amounts payable" operates effectively for taxpayers who report income on the accrual basis, it produces an unintended result in certain circumstances in respect of taxpayers who report income on the cash basis or method of accounting. A taxpayer using the cash basis or method of accounting who, in the current year, pays an amount in respect of the preceding year will lose the benefit of the interest deduction "room" for the preceding year (since the amount was not paid in that year) and may be denied a deduction of an amount in the current year, if the payment of both the preceding and current year's interest expenses exceeds the interest deduction "room" for the year of payment.

Accordingly, this section is amended to revise the formula to refer to the number of days in the period in respect of which the interest was paid or payable as the case may be. This amendment is applicable to taxation years and fiscal periods commencing after June 17, 1987 that end after 1987.

ITA
67.3

Section 67.3 restricts the amount that may be deducted in respect of leasing costs of a passenger vehicle. The deductible amount may not exceed the lesser of the amounts produced by two formulae. The first amount is determined by multiplying $600 (or such other amount as may be prescribed) by the number of 30 day periods that have elapsed during the lease and before the end of the relevant year, and deducting from that amount two further sums, where applicable: the total of all amounts deducted in preceding taxation years in respect of the lease of the vehicle and an amount in respect of interest that would be earned on that part of any refundable amount (to the extent that amount exceeds $1,000) paid in respect of the lease.

The second amount is determined by multiplying the total of the lease charges paid by the taxpayer during the year by the quotient obtained when $20,000 (or such other amount as may be prescribed) is divided by the greater of $23,529 (or such other amount as may be prescribed) and the aggregate of the manufacturer's list price for the vehicle and the provincial sales tax that would have applied if the vehicle had been purchased, at the time the first lease was entered into, in the province in which the vehicle was primarily used, and deducting from that amount, an amount in respect of imputed interest on any refundable amount paid in respect of the lease, as outlined above. The effect of this second formula is to place a restriction on lease expenses of passenger vehicles similar to that imposed in respect of the depreciable capital cost of such vehicles. This section operates in a manner similar to section 67.2 with respect to taxpayers on a cash basis.

The formulae in paragraphs 67.3(c) and (d) are amended to permit the deduction by taxpayers using the cash basis or method of calculating income, of amounts paid in respect of the cost of leasing a passenger vehicle. The description of "B" in paragraph 67.3(c) is clarified by a reference to the number of days in the period commencing at the beginning of the term of the lease and ending at the earlier of the end of the relevant year and the end of the lease.

The description of "A" in paragraph 67.3(d) is amended to refer to the aggregate of actual lease charges incurred in respect of the year, or actual lease charges paid in the year, depending upon the method regularly followed by the taxpayer in computing income. The description of "C" in paragraph 67.3(d) is amended to delete the reference to provincial sales tax with respect to leases entered into after 1990. This amendment is applicable with respect to taxation years and fiscal periods commencing after June 17, 1987 that end after 1987.

This section is also amended to ensure that, where a person leases a passenger vehicle and is reimbursed in whole or in part in respect of the lease costs, the restriction on the deductibility of lease costs will also apply to the person making the reimbursement. This amendment is applicable to taxation years that end after July 13, 1990.

Clause 46

Illegal Payments

ITA
67.5

New section 67.5 of the Act prohibits any deduction in respect of illegal payments made to government officials in Canada, officials engaged in the administration of justice in Canada, persons under a duty as agents or employees and persons responsible for collecting fares or admission fees. Deductions for such payments are prohibited under the new section where the payment is made to induce, or attempt to induce, the recipient to breach his or her duty and the payment is made for the purpose of doing anything that is an offence under any of sections 119 to 121, 123 to 125, 393 and 426 of the Criminal Code. Deductions are also prohibited under the new section where the payment is made in furtherance of a conspiracy to commit an offence under one of these sections or a conspiracy in Canada to commit a similar offence under the law of another country. New section 67.5, which applies to outlays made or expenses incurred after July 13, 1990, also empowers the Minister of National Revenue to reassess taxation years in order to give effect to this provision without regard to the normal time limits on reassessments.

Clause 47

Inadequate and
Unreasonable Consideration

ITA
69

Section 69 of the act provides rules dealing primarily with transactions entered into for inadequate or unreasonable consideration.

Subclause 47(1)

ITA
69(3)

Subsection 69(3) is an anti-avoidance rule designed to prevent the understatement of revenues in computing income. The amendment to this subsection clarifies that it will apply to treat a reasonable amount as having been received by a taxpayer only where no amount, or an amount less than a reasonable amount, was paid or agreed to be paid by a non-arm's length non-resident person for property received from or services rendered by the taxpayer. This amendment applies to transactions and events occurring after July 13, 1990.

Subclause 47(2)

ITA
69(5)

Subsection 69(5) of the Act sets out rules to ensure that, where property is appropriated to a shareholder on the winding-up of a corporation, the property is to be treated as having been transferred at its fair market value with the consequent recognition of any resulting income or loss on the transfer. Subsection 69(5) is amended by adding new paragraph (e) which provides that paragraph 40(2)(e) of the Act does not apply to any loss realized by the shareholder on the disposition of shares to the corporation on the winding-up. This amendment ensures that any loss realized by the shareholder on the disposition of such shares may be recognized in computing the shareholder's income for the year in which the disposition occurred. New paragraph 69(5)(e) applies to dispositions of shares occurring after 1985.

Clause 48

Death of a Taxpayer

ITA
70

Section 70 of the Act provides certain rules that apply upon the death of a taxpayer.

Subclause 48(1)

ITA
70(5.1)

Subsection 70(5.1) of the Act provides a tax deferral where, as a consequence of a taxpayer's death, any person, other than the taxpayer's spouse or a corporation that was controlled by the taxpayer, has acquired eligible capital property of the taxpayer. Where an eligible capital property is transferred pursuant to subsection 70(5.1) from a taxpayer to a person who carries on the business previously carried on by the taxpayer, the person will be treated as having made an expenditure in respect of that eligible capital property equal to the aggregate of the taxpayer's cumulative eligible capital and the unrecaptured deductions under paragraph 20(1)(b) previously taken by the taxpayer in respect of that eligible capital property. Subsection 70(5.1) is amended to ensure that the amount referred to in subparagraph 70(5.1)(b)(ii) (that is, the unrecaptured deductions previously taken by the deceased taxpayer) is grossed up by 4/3 to provide, in view of the 3/4 inclusion rate in respect of eligible capital expenditures, that the transferee is placed in the same tax position as the transferor with respect to the property. In addition, subsection 70(5.1) is amended to clarify the intended application of this provision in situations where more than one person receives eligible capital property as a result of the death of a taxpayer.

Subsection 70(5.1) is also amended to exclude from its application distributions of eligible capital property made by a testamentary trust where the trust has claimed deductions under 20(1)(b).

New subsection 70(5.1) of the Act applies to acquisitions occurring as a consequence of the death of a taxpayer after the commencement of the first fiscal period of the taxpayer commencing after 1987, except that distributions by a trust occurring before July 13, 1990 will also qualify, where all other conditions are met, for the treatment provided under this subsection.

Subclauses 48(2), (3), (5) and (6)

ITA
70(6), (9.2) and (9.3)

Subsection 70(6) of the Act sets out certain rules that apply to the transfer of property on the death of a taxpayer where the transfer is to a spouse or spouse trust (a "transferee"). Paragraph 70(6)(d) is amended and new paragraph 70(6)(d.1) is added to provide that, where the property transferred is an interest in a partnership (other than an interest to which subsection 100(3) of the Act applies), the taxpayer will be treated, except for the purposes of paragraph 98(5)(g) of the Act, as not having disposed of the interest immediately before his death and the transferee will be treated as having acquired the interest at its cost to the taxpayer. In order to place the transferee in the same tax position as the taxpayer, any amount added or deducted by the taxpayer under subsection 53(1) or 53(2) in respect of the partnership interest will be similarly added or deducted, as the case may be, in computing the transferee's adjusted cost base of the interest. These amendments apply to transfers, distributions and acquisitions occurring after January 15, 1987.

Subsection 70(9.2) of the Act sets out certain rules that apply to the transfer of a share of a family farm corporation or an interest in a family farm partnership on the death of a taxpayer where the transfer is to a child of the taxpayer. Subsection 70(9.3) of the Act provides for a similar transfer on the death of a spouse where the transfer of a taxpayer's share or interest is from a spouse trust to a child of the taxpayer.

Subsections 70(9.2) and (9.3) are amended to provide that, where the property transferred is an interest in a family farm partnership (other than an interest to which subsection 100(3) applies), the interest will be treated, except for the purposes of paragraph 98(5)(g), as not having been disposed of by the taxpayer or the spouse trust, as the case may be, and the child will be treated as having acquired the interest at its cost to the taxpayer or trust. In order to place the child in the same tax position as the transferor, each amount added or deducted by the transferor under subsection 53(1) or 53(2) in respect of the partnership interest will be similarly added or deducted in computing the child's adjusted cost base of the interest. The amendments to subsections 70(9.2) and (9.3) apply to transfers, distributions and acquisitions occurring after January 15, 1987.

Subclause 48(4)

ITA
70(7)

Subsection 70(5) of the Act generally provides for a deemed realization of depreciable and other capital property by a taxpayer immediately before the death of a taxpayer. The realization of depreciable property on death takes place at the midpoint between undepreciated capital cost and fair market value. The realization of other capital property takes place at fair market value. However, where such property is distributed on a taxpayer's death to the taxpayer's spouse or a qualifying spouse trust in favour of the spouse, subsection 70(6) provides for rollover of such property from the taxpayer to the spouse or trust.

A qualifying spouse trust under paragraph 70(6)(b) is one established by the will of a taxpayer under which the surviving spouse of the taxpayer is entitled to all of the trust income before the survivor's death. In addition, only the survivor is entitled to receive or otherwise obtain the use of the income or capital of the trust before the survivor's death.

Subsection 70(7) provides rules under which certain "tainted" spouse trusts may be considered as qualifying spouse trusts for the purposes of the rollover under subsection 70(6). These rules apply where a spouse trust is not a qualifying spouse trust because of the payment of, or provision for payment of, certain testamentary debts. Essentially, these rules provide for a mechanism by which such testamentary debts may be applied against money and other property of the trust specified by the legal representatives of the deceased taxpayer whose will created the trust. Such specified property would be subject to the normal deemed realization rules under subsection 70(5) whereas the remaining property subject to the rollover rules under subsection 70(6). Under paragraph 70(7)(a), such legal representatives are allowed to file the taxpayer's terminal return reflecting such specification of trust property up to 18 months following the taxpayer's death. Paragraph 70(7)(a) also provides that the extended filing deadline for the terminal return does not result in any reduction of arrears interest under section 161.

Paragraph 70(7)(a) is amended to ensure that, where a taxpayer created a tainted spouse trust to which subsection 70(7) applied, the legal representatives of the taxpayer will continue to be allowed to file the taxpayer's terminal return up to 18 months following the death of the taxpayer. This amendment is strictly consequential to the amendment to paragraph 150(1)(b) described below in the commentary on that paragraph.

Paragraph 70(7)(a) is also amended to eliminate the reference to section 161. The reference is redundant because an amendment to subsection 161(1) in 1988 provided that arrears interest thereunder would be no longer be determined for the period commencing on the day that an income tax return was required to be filed. Rather, the amendment provided for the determination of such interest for the period commencing on the day that a taxpayer was required to pay the remainder of his or her tax payable.

These amendments are applicable to the 1990 and subsequent taxation years.

Subclause 48(7)

ITA
70(9.8)

Subsection 70(9.8) of the Act treats, for the purposes of the provisions relating to intergenerational transfers of farm property, property owned by a taxpayer but used by a family farm corporation or partnership of the taxpayer, his spouse or any of his children to be property used by the taxpayer in the business of farming. This subsection is amended to also apply for the purposes of subsection 14(1) and paragraph 20(1)(b) of the Act, which relate to the amounts that may be included or deducted in computing a taxpayer's income in respect of eligible capital property, and for the purposes of paragraph (d) of the definition "qualified farm property" in subsection 110.6(1) of the Act, which relates to a taxpayer's entitlement to claim a capital gains exemption in respect of the disposition of eligible capital property used in a farming business.

This amendment applies to the 1986 and subsequent taxation years.

Clause 49

Reserves for Year of Death

ITA
72

Section 72 of the Act provides rules for dealing with certain reserves in the year of a taxpayer's death.

Subclause 49(1)

ITA
72(1)(c)

Paragraph 72(1)(c) of the Act currently provides that, in computing the amount of any gain of a taxpayer for the year in which the taxpayer has died, no reserve may be claimed under subparagraph 40(1)(a)(iii) in respect of proceeds of disposition not due until after the end of that year. This amendment, which applies to the 1990 and subsequent taxation years, provides that a capital gains reserve under the rules in subparagraph 44(1)(e)(iii) of the Act in respect of replacement property is also unavailable in computing gains in the year of a taxpayer's death.

Subclause 49(2) to (4)

ITA
72(2)(b) and (c)

Subsection 72(2) of the Act permits certain reserves that, but for subsection 72(1), would have been allowed to a taxpayer for a taxation year in respect of amounts receivable after the end of a taxation year to be claimed by a spouse or spouse trust of the taxpayer if the right to receive those amounts have been transferred to the spouse or trust as a consequence of the taxpayer's death. These amendments, which apply to the 1990 and subsequent taxation years, extend the application of the rules in subsection 72(2) to capital gains reserves under the replacement property rules in paragraph 44(1)(e) of the Act.

Clause 50

Inter Vivos Transfers

ITA
73

Subsection 73(1) of the Act permits a taxpayer to transfer capital property on a tax-deferred basis to a spouse or former spouse or to a trust established for that person's behalf. Paragraph 73(1)(d), in conjunction with Regulation 6500, currently extends the "rollover" treatment available under subsection 73(1) to situations in which a court has ordered a transfer of capital property as part of its powers to make an order for support under the Family Law Reform Act of Ontario (now the Family Law Act).

This amendment to paragraph 73(1)(d), which applies to transfers occurring after July 13, 1990, deletes the requirement that such court-ordered transfers be made under prescribed provincial laws and to prescribed persons. New paragraph 73(1)(d) will now provide that the benefits of subsection 73(1) of the Act will be available in any situation in which a court, in accordance with the applicable provincial law and as part of an order for maintenance or support, directs that a taxpayer's capital property be transferred to an individual of the opposite sex with whom the taxpayer cohabited in a conjugal relationship before that time.

Clause 51

Attribution - Capital Gains

ITA
74.2(2)

Subsection 74.2(2) of the Act provides that taxable capital gains and allowable capital losses attributed to a taxpayer in a taxation year pursuant to certain provisions of the Act will be treated, for the purposes of the lifetime capital gains exemption under section 110.6, as having arisen on the disposition by the taxpayer in that year of the property from which the gain or loss was realized. This subsection is amended, effective for the 1987 and subsequent taxation years, to include a reference to subsection 75(2) of the Act, which deals with reversionary trusts and trusts of similar nature. This amendment is intended to ensure that taxable capital gains of a trust that are attributed to an individual by reason of subsection 75(2) will be eligible for the capital gains exemption to the same extent and in the same manner as if the gain had been realized directly by the individual.

Clause 52

Transfers and Loans to Corporations

ITA
74.4(2)

Subsection 74.4(2) of the Act requires an individual who transfers or loans property to a corporation (other than a small business corporation) in circumstances where one of the main purposes of the transfer may reasonably be considered to be to reduce the income of the individual, and to benefit a person who is a designated person in respect of the individual, to include in income the amount by which interest at the prescribed rate on the loan exceeds the aggregate of any interest actually received on the loan and 5/4 of any dividends received on shares issued for the transfer. This subsection is amended, effective for the 1987 and subsequent taxation years with respect to loans and transfers made after October 27, 1986, to ignore in determining whether a designated person is a specified shareholder of a corporation any shareholdings of the designated person in a related small business corporation.

Clause 53

Income Attribution

ITA
74.5(3)

Subsection 74.2(1) of the Act attributes to an individual any taxable capital gains and allowable capital losses realized on the disposition of property, or property substituted therefor, that was loaned or transferred by the individual to or for the benefit of that person's spouse. However, paragraph 74.5(3)(b) provides an exemption from these rules in the event that the spouses separate and the individual files an election, completed jointly with the individual's spouse, in the individual's return of income for the year in which the separation occurred. This paragraph is amended to modify the requirement that the election be filed with the income tax return for the taxation year during which the spouses separated. New paragraph 74.5(3)(b) provides that the joint election may be filed for any taxation year ending after the time of the separation. Where the joint election is so filed, section 74.2 will not apply for the year in which the election is filed (or any subsequent year) in respect of any gain or loss from a disposition of property, or property substituted therefor, that occurs during the period throughout which the spouses are living separate and apart by reason of a breakdown of their marriage.

This amendment applies to transfers of property made after May 22, 1985 and loans outstanding on or after May 22, 1985.

Clause 54

Attribution of Gains and Losses

ITA
75.1(1)

Subsection 75.1(1) of the Act provides attribution rules in respect of certain farm property transferred by a taxpayer to his child where the transfer was made at less than fair market value and the child disposes of the property before the taxation year in which he attained the age of 18. Subsection 75.1(1) is amended, applicable to property transferred after 1989, to apply the same rules to transfers by a taxpayer to his child of shares of a family farm corporation and interests in a family farm partnership.

Clause 55

Security in Satisfaction of Income Debt

ITA
76(1) and (2)

Section 76 of the Act provides special rules which apply in circumstances where a taxpayer has received a security, right or debt as consideration for the disposition of all or part of an existing debt that, if paid, would have been included in the taxpayer's income. These amendments to subsections 76(1) and (2), which apply to securities, rights and indebtedness received after July 13, 1990, are strictly technical and correct grammatical errors currently contained in those provisions.

Clause 56

Unpaid Remuneration

ITA
78(4)

Subsection 78(4) of the Act delays the recognition for tax purposes of a taxpayer's expense in respect of salary, wages or other remuneration, that is not paid within 180 days after the end of the taxation year in which it is incurred. In such a case, a deduction may generally only be taken in the subsequent taxation year in which the remuneration is actually paid. The purpose of this rule is to eliminate the opportunity for an undue tax deferral that would otherwise be available if a current deduction were provided for unpaid remuneration that is not included in employees' incomes until actually received.

Subsection 78(4) is amended, effective with respect to expenses incurred after July 1990, so that unfunded obligations in respect of pension benefits and retiring allowances are treated in the same manner. The rule is not intended to have any application in respect of contributions paid to registered pension plans or retirement compensation arrangements.

Clause 57

Foreclosures and Repossessions

ITA
79(e)

Paragraph 79(e) of the Act provides that, for the purpose of computing a taxpayer's income for a taxation year, a reserve taken under subparagraph 40(1)(a)(iii) in computing the taxpayer's gain or under paragraph 20(1)(n) in computing the taxpayer's income for the immediately preceding year is deemed to be nil where, as a result of another person's failure to pay an amount owing to the taxpayer in respect of the disposition of a property, the taxpayer acquires or reacquires beneficial ownership of the property in respect of which the reserve had been claimed. The amount of this reserve is, instead, deducted from the cost to the taxpayer of the property, thereby deferring recognition of any further income or gain in respect of the property until it is subsequently disposed of by the taxpayer.

This amendment, which applies after July 12, 1990 (or, where the taxpayer so elects before July 1991, after 1985), adds a reference in subparagraph 79(e)(i) to subparagraph 44(1)(e)(iii) of the Act, and is intended to extend the treatment described above to capital gains reserves claimed under subparagraph 44(1)(e)(iii) in respect of dispositions of property for which a replacement property has been acquired.

Clause 58

Gain on Settlement of Debt

ITA
80(4)

Subsection 80(4) of the Act treats, for the purposes of subsections 80(1) and (3) dealing with a debtor's gain on the settlement of debts, interest payable by a debtor as having a certain principal amount. Subsection 80(4) is amended so that the amount of interest payable is also treated as a debt or obligation issued by the taxpayer for its principal amount. Subsection 80(4) is applicable with respect to settlements after May 9, 1985 except that for interest accruing before July 14, 1990 the first use of the word "deductible" shall be read as "deducted".

Clause 59

Destruction of Livestock and Drought-Induced Sales

ITA
80.3

Section 80.3 of the Act provides for a tax deferral in respect of the proceeds of sales by farmers of breeding livestock herds due to drought conditions. It provides that the income of a taxpayer for a year that is deferred pursuant to that section is to be included in the taxpayer's income in the earlier of the year in which the taxpayer dies or the year following a drought year, or series of consecutive drought years, as the case may be.

Subclause 59(1)

ITA
80.3(5)

Subsection 80.3(5) is amended to provide that the deferred amount must be included in income no later than the first year at the end of which the taxpayer is not resident in Canada and not carrying on the business through a fixed place of business in Canada. The amendment also provides for an election by the taxpayer for an earlier income inclusion of the deferred amount.

Subclause 59(2)

ITA
80.3(6)(b)

Paragraph 80.3(6)(b) is amended to provide that the income deferral under section 80.3 is not available where at the end of a taxation year a taxpayer is not resident in Canada and not carrying on a farming business through a fixed place of business in Canada.

The amendments to subsections 80.3(5) and (6) of the Act apply to fiscal periods and taxation years ending after 1987.

Clause 60

Home Purchase Loans

ITA
80.4(7)(a)

Subsection 80.4(1) of the Act treats an individual or a corporation that carries on a personal service business as having received a benefit in a taxation year in respect of certain employment-related low-interest or non-interest bearing loans. The benefit is generally computed by reference to the prescribed interest rate prevailing during the term of the loan.

Subsections 80.4(4) and (6), however, provide special rules in computing the benefit for a year in respect of a home purchase loan received by reason of a taxpayer's office or employment. As a result of these subsections, the amount of the benefit is determined by reference to the lesser of the prescribed rate of interest in effect during the year and the prescribed rate that was in effect at the later of the time the home purchase loan was made and the last five-year anniversary of the loan.

Paragraph 80.4(7)(a), which provides the definition of the expression "home purchase loan" for the purposes of these rules, is amended to expand the definition of "home purchase loan" to include a loan used to acquire a share of a co-operative housing corporation entitling the purchaser or a related person to inhabit a dwelling unit owned by such corporation. This amendment applies to the 1985 and subsequent taxation years.

Clause 61

Exempt Income

ITA
81

Section 81 of the Act lists various amounts which are not included in computing a taxpayer's income.

Subclause 61(1)

ITA
81(1)(d)

Paragraph 81(1)(d) of the Act specifically exempts from income certain payments made to war veterans and their families. However, there is no specific exemption for awards made to gallant members of the Canadian Forces for conspicuous and distinguished service during a war. The annuities paid under these awards represent relatively small amounts which, prior to recent amendments to paragraph 56(1)(n), were effectively excluded from income by reason of the $500 exemption provided under that paragraph. This amendment, which applies to the 1986 and subsequent taxation years, adds a reference in paragraph 81(1)(d) to payments made under the Gallantry Awards Order.

Subclause 61(2)

ITA
81(1)(e)

Paragraph 81(1)(e) of the Act provides that pension payments received on account of death or disability arising out of war service, from a country that was an ally at the time of that service, are exempt from tax under Part I of the Act. New paragraph 81(1)(e), which applies to the 1988 and subsequent taxation years, extends this exemption to pension payments received on account of disability or death arising out of a war from a country that was an ally of Canada. As amended, this paragraph requires only that such disability or death arise out of a war rather than out of "war service", and is intended to permit pensions paid to civilian war casualties by other countries to benefit from the exemption (provided that those other countries grant similar relief in respect of Canadian pensions).

Subclause 61(3)

ITA
81(1)(h)

New paragraph 81(1)(h) of the Act specifically exempts from income social assistance payments made to an individual for the benefit of a foster person (child or adult) under the individual's care where the individual and the foster person reside together in the individual's principal place of residence. The exemption also applies to amounts (often called "bed reservation fees") paid to individuals to maintain their residence available for use by a foster person. This amendment, which clarifies the scope of previous amendments made to paragraph 56(1)(u) of the Act, applies to the 1982 and subsequent taxation years.

Subclause 61(4)

ITA
81(1)(r)

New paragraph 81(1)(r) of the Act exempts from income amounts credited or added to a deposit or account governed by a foreign retirement arrangement, as newly defined in subsection 248(1). The exemption applies only where the only reason that the amount would have otherwise been included in a taxpayer's income is such crediting or adding.

This new paragraph, which is similar to a rule in subsection 146(20) with respect to registered retirement savings plans, is intended to ensure that an individual is required to include amounts out of a foreign retirement arrangement in income only after such amounts are paid out of the plan. The rule is necessary because the custodians of certain foreign retirement arrangements would be agents and not trustees with respect to individuals residing in Canada.

This amendment applies to the 1990 and subsequent taxation years.

Clause 62

Deemed Dividends

ITA
84

Section 84 of the Act provides that certain transactions involving the shares of a corporation, such as share redemptions, winding-up distributions and certain increases and reductions of paid-up capital, will be treated as producing dividends for tax purposes.

Subclauses 62(1) and (2)

ITA
84(1)

Subsection 84(1) of the Act treats a dividend as having been paid by a corporation on the shares of a class of its capital stock where the paid-up capital is increased by the corporation in circumstances other than those set out in that subsection.

Paragraph 84(1)(c.3) of the Act provides that a dividend will not be treated as having been paid under subsection 84(1) where a corporation, other than an insurance corporation or a bank, converts into paid-up capital of a class of its shares any contributed surplus that arose on the issuance of shares of that class after March 31, 1977, other than an issuance to which certain special provisions of the Act applies. Two amendments are being made to this paragraph.

The first amendment is contained in subparagraph 84(1)(c.3)(ii), and expands the application of paragraph 84(1)(c.3) to include contributed surplus of a corporation that arose in circumstances where shares were not issued by the corporation - for example, on a contribution of property by a shareholder. New subparagraph 84(1)(c.3)(ii) provides that a conversion of contributed surplus into paid-up capital of a class of its shares by a corporation will not be treated as a dividend where the contributed surplus arose as a result of a disposition after March 31, 1977 of property by a shareholder of that class to the corporation in circumstances where shares of the corporation were not received by the shareholder as consideration for that disposition.

The second amendment is contained in new subparagraph 84(1)(c.3)(iii), and expands the application of paragraph 84(1)(c.3) to include contributed surplus of a corporation that arose after March 31, 1977 on a reduction of paid-up capital to the extent permitted by new subsection 84(10).

The amendments to paragraph 84(1)(c.3) are applicable to actions taken to convert contributed surplus into paid-up capital after July 13, 1990.

New paragraph 84(1)(f), which applies after 1985, clarifies that a dividend arising by reason of subsection 84(1) will be reduced to the extent that the increase in the paid-up capital of the relevant class of shares arose as a result of capitalizing contributed surplus in circumstances described in paragraph 84(1)(c.1), (c.2) or (c.3).

Subclause 62(3)

ITA
84(7)

Subsection 84(7) of the Act provides that an amount treated under section 84 or 212.1 to have been paid at a particular time as a dividend is to also be regarded, for the purposes of Subdivision h of Division B in Part I of the Act, to have become payable at that time. This amendment, which applies to dividends paid after 1988, provides that dividends deemed to have been paid under section 84.1 will also be treated as having become payable for these purposes, and that dividends arising under sections 84, 84.1 or 212.1 will be treated as having become payable for the purposes of the rules relating to mutual fund corporations in sections 131 (which also has application to investment corporations under section 130) and the rules relating to non-resident-owned investment corporations in 133 of the Act.

Subclause 62(4)

ITA
84(10)

New subsection 84(10) of the Act limits the amount of the contributed surplus of a public corporation that can, under paragraph 84(10)(c.3), be shifted into paid-up capital without triggering a deemed dividend. The limitation is, first, that contributed surplus shall not include any amount in respect of which a dividend was paid to the corporation's shareholders and, second, that contributed surplus is to be reduced by the excess of any dividends paid over retained earnings. New subsection 84(10) applies to the computation of contributed surplus after July 13, 1990.

Clause 63

Non-Arm's Length Disposition of Shares

ITA
84.1

Section 84.1 of the Act is an anti-avoidance rule designed to prevent the removal of taxable corporate surplus as a tax-free return of capital through a non-arm's length transfer of shares by an individual resident in Canada to a corporation.

Subclause 63(1)

ITA
84.1(1)(b)

Paragraph 84.1(1)(b) of the Act treats a dividend in certain circumstances as having been paid by a "purchaser corporation" to a taxpayer when the taxpayer disposes of the shares of another corporation (the "subject corporation") to the purchaser corporation. The amendment to this paragraph, which applies to dispositions made after May 22, 1985, clarifies that the taxpayer is also considered to have received the dividend paid to him for the purposes of the Act.

Subclauses 63(2) and (3)

ITA
84.1(2)

Paragraph 84.1(2)(b) of the Act treats a taxpayer as not being at arm's length with a "purchaser corporation" if the taxpayer was, immediately before the disposition, one of a group of less than 6 persons that controlled the "subject corporation" and, immediately after the disposition, one of a group of less than 6 persons that controlled the purchaser corporation. For the purposes of applying this rule, paragraph 84.1(2)(c) treats shares that are owned by the taxpayer's spouse or certain corporations or inter vivos trusts as being owned by the taxpayer and not by the person who actually owned them.

Paragraph 84.1(2)(c) is amended, applicable to dispositions of shares occurring after July 13, 1990, to treat shares owned by the taxpayer's child, as defined in paragraph 70(10)(a) of the Act, as being owned by the taxpayer where the child is under 18 years of age. For these purposes, therefore, a taxpayer will be treated as owning shares held by a grandchild or great-grandchild of the taxpayer or by any person who is under the age of 18, is wholly dependent on the taxpayer for support and is under the taxpayer's custody and control.
Subparagraphs 84.1(2)(c)(ii) and (iii) are also amended to include, in determining whether a taxpayer is part of a group that controls a particular corporation, shares owned by any trust of which the taxpayer, the taxpayer's spouse or child or a corporation controlled by such persons is a beneficiary, as well as shares owned by

a corporation that is controlled by the taxpayer, the taxpayer's spouse or child or a trust of which any such person is a beneficiary.

New paragraph 84.1(2)(d) provides that in determining, for the purposes of section 84.1 of the Act, whether a taxpayer has disposed of shares to a corporation with which he does not deal at arm's length, a trust and a beneficiary of the trust or a person related to a beneficiary of the trust will be treated as not dealing with each other at arm's length. As a result, a disposition by a trust to a corporation that is controlled by beneficiaries of the trust or persons related to such beneficiaries will be treated as a disposition to a corporation with which the trust does not deal at arm's length. New paragraph 84.1(2)(d) applies to dispositions of shares occurring after July 13, 1990.

Subclause 63(4)

ITA
84.1(2.1)

New subsection 84.1(2.1) of the Act provides a special rule that applies for the purposes of subparagraph 84.1(2)(a.1)(ii). Paragraph 84.1(2)(a.1) applies to determine, for the purposes of subsection 84.1(1), the adjusted cost base to a taxpayer of a share that was acquired by the taxpayer after 1971 from a person with whom he was not dealing at arm's length, or that was a share substituted for such a share or for a share owned by the taxpayer at the end of 1971. The taxpayer's adjusted cost base, otherwise determined, of such a share is reduced under subparagraph 84.1(2)(a.1)(ii) by the lesser of the capital gain realized by the taxpayer or a non-arm's length person in respect of a previous disposition and the portion of the whole gain in respect of which a capital gains exemption was claimed by the taxpayer or the non-arm's length person. The effect of this reduction is to allow the adjusted cost base of a share to be increased on a non-arm's length transfer only to the extent that any capital gain arising on that transfer was taxed.

New subsection 84.1(2.1) applies for the purposes of subparagraph 84.1(2)(a.1)(ii) to treat, in certain circumstances, the taxpayer or a non-arm's length person as having claimed a capital gains exemption in respect of a portion of a gain arising on a previous disposition of the share or a share for which it was substituted. Subsection 84.1(2.1) applies where the taxpayer or the non-arm's length person claims a capital gains reserve under subparagraph 40(1)(a)(iii) for the year in which the previous disposition occurred. In such a case, the transferor will be treated as having claimed, for the year in which the disposition took place, a capital gains exemption in respect of the disposition equal to the lesser of two amounts. The first amount is the total of the reserve claimed under subparagraph 40(1)(a)(iii) by that transferor and 4/3 of the amount actually deducted by that person for that year under section 110.6 of the Act. The second amount is 4/3 of the maximum amount of capital gains exemption that could have been claimed in that year by the transferor if no reserve under subparagraph 40(1)(a)(iii) had been claimed and if the exemption claimed by the transferor in the year had been applied first in respect of gains arising from dispositions of property to which subsection 84.1(2.1) does not apply. In order to ensure that the maximum amount of the exemption that could be claimed in a year in respect of a share reflects amounts that have already reduced the adjusted cost base of other shares in the year, any amount determined under subsection 84.1(2.1) in respect of a share will be treated, for the purposes of determining the maximum amount of capital gains exemption that may be claimed in respect of the share, as having been deducted under section 110.6.

> The following example illustrates the operation of new subsection 84.1(2.1). Assume that a person who was not dealing at arm's length with a taxpayer realized a $1,000 gain on the transfer of a share to the taxpayer. The non-arm's length person claims a reserve under subparagraph 40(1)(a)(iii) in respect of $600 of the capital gain and pays no tax on the remaining $400 capital gain by claiming a $300 capital gains exemption under section 110.6. Assume also that the non-arm's length person had $2,000 of unclaimed capital gains exemption remaining after the end of the year in which the transfer occurred. Under new subsection 84.1(2.1) the non-arm's length person would be considered to have claimed a capital gains exemption in respect of the whole $1,000 capital gain determined as the lesser of (a) and (b) where:
>
> (a) is the total of
>
> | | | |
> |---|---|---|
> | (i) reserve under 40(1)(a)(iii) | $600 | |
> | (ii) 4/3 of the 110.6 deduction | $400 | |
>
> and
>
> (b) is 4/3 of the maximum amount that could have been deducted under section 110.6 in respect of the taxable gain if no reserve under 40(1)(a)(iii) had been claimed $1,000

New subsection 84.1(2.1) of the Act applies to dispositions occurring after July 13, 1990.

Clause 64

Transfers to a Corporation

ITA
85

Subsection 85(1) of the Act provides rules under which a taxpayer or partnership may transfer certain property on a tax-deferred or "rollover" basis to a taxable Canadian corporation in exchange for consideration that includes shares of the corporation.

Subclause 64(1)

ITA
85(1)(c.2)

New paragraph 85(1)(c.2) applies when a taxpayer who carries on a farming business and, for income tax purposes, uses the cash method of accounting in respect of that business, disposes of inventory in circumstances to which section 85 applies.

New subparagraph 85(1)(c.2)(i) treats the taxpayer's proceeds of disposition of inventory purchased by the taxpayer and the corporation's cost of the inventory to be the aggregate of two amounts. The first of these amounts is the proportion of the amount that would have been included under paragraph 28(1)(c) of the Act in computing the taxpayer's income, if the taxpayer's taxation year had ended at the time of the disposition, that the value of the purchased inventory disposed of is of the value of all purchased inventory owned by the taxpayer at that time. The second of these amounts is such additional amount as the taxpayer and the corporation designate in respect of the property. This designated amount may be any amount between zero and the amount that will, when added to the first amount described above, bring the total deemed proceeds of the inventory disposed of up to its fair market value. In effect, therefore, the second amount is analogous to the amount that the taxpayer would have been able to specify as a flexible inventory adjustment pursuant to paragraph 28(1)(b) of the Act, if the year had ended immediately before the disposition of the inventory. The purpose of new subparagraph 85(1)(c.2)(i) is, in part, to prevent the transfer of purchased inventory by a taxpayer to a corporation at nil cost in order to avoid the application of the mandatory inventory adjustment under paragraph 28(1)(c).

New subparagraphs 85(1)(c.2)(ii) and (iii) treat the proceeds of disposition of inventory transferred to the corporation as having been received by the taxpayer and provides that, where the corporation also computes its income using the cash method, the corporation's cost of the inventory shall be deemed to be an amount paid by the corporation. These amendments are intended to ensure that the taxpayer will include the proceeds of disposition in income under subparagraph 28(1)(a)(i) of the Act and that the corporation will be entitled to deduct the cost of the inventory under subparagraph 28(1)(e)(i) of the Act.

New paragraph 85(1)(c.2) applies to dispositions of property occurring after July 13, 1990.

Subclause 64(2)

ITA
85(1)(e.2)

Paragraph 85(1)(e.2) of the Act applies where a taxpayer transfers property to a corporation under subsection 85(1) and the fair market value of the transferred property exceeds the fair market value of the consideration received. In such a case, if it is reasonable to regard any portion of such excess as a benefit that the taxpayer wished to confer on a related person, special rules apply.

A recent modification to paragraph 85(1)(e.2) (S.C. 1988, C. 55, subsection 58(4)) made it applicable with respect to a benefit conferred on the transferee corporation. Such results are inappropriate where the transferee corporation is a wholly-owned corporation of the taxpayer immediately after the transfer. Paragraph 85(1)(e.2) is therefore amended, applicable to dispositions after June 1988, to exempt from its application transfers to a wholly-owned corporation of the taxpayer. New subsection 85(1.3) defines "wholly-owned corporation" for this purpose.

Subclauses 64(3) and (4)

ITA
85(1.1), (1.2) and (1.3)

Subsection 85(1.1) of the Act describes the various types of "eligible property" that may be transferred to a corporation under subsection 85(1). Eligible property does not include a capital property of a non-resident person (other than a non-resident insurer) that is real property or an interest in or option in respect of such property. The exclusion of real property of non-residents from the application of subsection 85(1) is intended to ensure that Canadian tax is not avoided or deferred in respect of capital gains that have accrued on such property. Under the terms of tax treaties entered into between Canada and other countries, Canada retains the right to tax residents of another country on their capital gains that are realized on dispositions of real property situated in Canada. If a rollover were provided under subsection 85(1) in respect of a transfer of such property to a taxable Canadian corporation, however, any accrued gain in respect of Canadian real property could be deferred or avoided by selling the shares of the corporation. Pursuant to many of Canada's treaties, capital gains of non-residents from dispositions of shares of a Canadian company may be taxed by Canada only if the value of those shares is derived principally from real property situated in Canada.

In the case of the incorporation of a Canadian branch by a non-resident person, the deferral of Canadian tax on real property situated in Canada is not normally a significant consideration in arriving at the decision to incorporate. Accordingly, subsection 85(1.1) is being amended, by adding new paragraph (h), to allow a non-resident to transfer real property under subsection 85(1) where the property was used by the non-resident in the course of carrying on a business in Canada and the conditions set out in new subsection 85(1.2) of the Act are met.

New subsection 85(1.2) sets out three conditions that must be met in order for a non-resident to transfer real property to a Canadian corporation under subsection 85(1). These conditions are intended to ensure that only those transfers that are part of the incorporation of a Canadian branch are allowed on a tax-deferred basis under subsection 85(1). First, the transfer must be to a corporation controlled by the taxpayer, persons related to the taxpayer or the taxpayer together with those persons. Second, all or substantially all of the property used in the course of carrying on the business in Canada in which the real property is used must be transferred by the taxpayer to the corporation. Finally, the transfer cannot be part of a series of transactions in which control of the corporation was acquired by a person or group of persons. In this regard, subsection 256(7) of the Act has been amended to provide that certain acquisitions of control, including those involving related persons, will not be considered to be an acquisition of control for the purposes of new subsection 85(1.2).

New paragraph 85(1)(h) and subsection 85(1.2) of the Act apply to dispositions occurring after 1989 and, where the transferor is a resident of a country with which Canada has a tax treaty and a provision of that treaty that was prescribed for the purposes of section 115.1 was effective for the time at which the disposition occurred, to dispositions occurring after 1984.

ITA
85(1.3)

New subsection 85(1.3) of the Act defines "wholly-owned corporation" for the purposes of the exemption in paragraph 85(1)(e.2). Essentially, section 85 transfers within a wholly-owned group of corporations will not be subject to the special rules in paragraph 85(1)(e.2). In these circumstances, therefore, no benefit will be considered to have been conferred even though the fair market value of the transferred property exceeds the fair market value of the consideration received. Subsection 85(1.3) is applicable to dispositions occurring after June 1988.

Subclauses 64(5) and (6)

ITA
85(4)

Subsection 85(4) of the Act applies where a taxpayer disposes of capital property or eligible capital property to a corporation that is controlled by the taxpayer, the taxpayer's spouse or a person or group of persons by whom the taxpayer is controlled. Paragraph 85(4)(a) will apply in these circumstances to deny to the taxpayer any capital loss or deduction under paragraph 24(1)(a) that would otherwise arise from the disposition. Where the taxpayer owns shares of the corporation, paragraph 85(4)(b) will add the denied loss to the adjusted cost base of those shares.

The preamble to subsection 85(4) is amended, applicable to dispositions occurring after July 13, 1990, to remove the requirement that the taxpayer would have, but for the application of certain other provisions of the Act, realized a capital loss, while ensuring that the subsection will not apply in respect of depreciable property of a prescribed class.

Paragraph 85(4)(a) currently applies, notwithstanding certain other enumerated provisions of the Act, to deem a taxpayer's capital loss or deduction under paragraph 24(1)(a) to be nil. The amendment to this paragraph, which is applicable after 1989, provides that it is to apply notwithstanding <u>any</u> other provision of the Act.

Paragraph 85(4)(b) is amended to provide that where a share is disposed of by a corporate taxpayer, the amount to be added to the taxpayer's adjusted cost base in respect of shares it owns in the controlled corporation is limited to the amount by which the loss realized by the taxpayer on the disposition of the share to the controlled corporation exceeds the amount by which the taxpayer's loss would, but for paragraphs 40(2)(e) and 85(4)(a), have been reduced by reason of subsection 93(2) or subsection 112(3) or (3.2). Where the taxpayer is a partnership, the reduction to the amount added to its adjusted cost base will be equal to the total amount by which subsection 112(3.1) reduced the amount of the loss of a corporate member of the partnership. The amendment to paragraph 85(4)(b), which applies to dispositions occurring after July 13, 1990, is intended to ensure that this provision does not operate to override the rules in subsections 93(2) and 112(3), (3.1) and (3.2) by adding the portion of any loss denied under those subsections to the adjusted cost base of the shares of the controlled corporation owned by the taxpayer.

Clause 65

Amalgamations

ITA
87

Section 87 of the Act provides rules which apply on the amalgamation of two or more taxable Canadian corporations. The amalgamated corporation is generally treated as a continuation of the predecessor corporations for the purposes of the Act.

Subclause 65(1)

ITA
87(2)(b)

Paragraph 87(2)(b) of the Act provides that, where a predecessor corporation has used the cash method of accounting prior to its amalgamation with another corporation, the new corporation formed on the amalgamation will be treated as having acquired the inventory of that predecessor corporation at a cost equal to the specified value of the inventory to that predecessor for its last taxation year as determined for the purpose of paragraph 28(1)(b).

This amendment to paragraph 87(2)(b) adds a reference to paragraph 28(1)(c) of the Act and is intended to ensure that, where a corporation receives inventory on an amalgamation from a predecessor corporation that computed its income under the cash method, the cost of that inventory to the new corporation will include the amounts, if any, included in computing the predecessor corporation's income under both of paragraphs 28(1)(b) and (c) of the Act.

Paragraph 87(2)(b) is also amended to provide that, where the new corporation also computes its income under the cash method, the cost of the inventory to the new corporation will be deemed to be an amount paid by the new corporation. This amendment ensures that the new corporation will be entitled to deduct the cost of the inventory under paragraph 28(1)(e) of the Act.

These amendments are generally applicable to amalgamations occurring after 1988.

Subclause 65(2)

ITA
87(2)(d)(ii)(C)

Clause 87(2)(d)(ii)(C) of the Act contains an incorrect reference to subparagraph 13(5)(a)(ii). Subsection 13(5) was amended, effective for taxation years and fiscal periods commencing after June 17, 1987 that end after 1987, and the previous subparagraph 13(5)(a)(ii) was renumbered as subparagraph 13(5)(b)(ii). Clause

87(2)(d)(ii)(C) is, therefore, amended as a consequence of the amendment to subsection 13(5), to refer to new subparagraph 13(5)(b)(ii), effective for taxation years commencing after June 17, 1987 that end after 1987.

Subclause 65(3)

ITA
87(2)(j.3)

Paragraph 87(2)(j.3) of the Act provides that a corporation formed as a result of an amalgamation under section 87 is treated as the same corporation as its predecessors for the purposes of paragraph 20(1)(oo) and other specified provisions. A similar rule also applies to a parent corporation on the winding-up of its subsidiary under section 88 by virtue of the reference to paragraph 87(2)(j.3) in paragraph 88(1)(e.2). The effect of the reference to paragraph 20(1)(oo) is to permit an amalgamated corporation or parent corporation, as the case may be, to deduct amounts included in employees' income as a deferred amount under a salary deferral arrangement where such inclusion relates to services rendered to one of its predecessors or to a subsidiary before being wound up.

Paragraph 87(2)(j.3) is amended by adding a reference to new paragraph 20(1)(pp) so that deductions for an amalgamated corporation or parent corporation are determined as if such corporation were the same corporation as each of its predecessors or its subsidiary. This amendment is strictly consequential to the introduction of new paragraph 20(1)(pp) relating to salary deferral arrangements.

The amendment applies to amalgamations occurring and windings-up commencing after 1985.

Subclause 65(4)

ITA
87(2)(j.6)

Paragraph 87(2)(j.6) of the Act provides that a corporation formed as the result of an amalgamation is considered, for the purposes of a number of provisions of the Act, to be the same corporation as and a continuation of each predecessor corporation. Paragraph 87(2)(j.6) is amended to provide that this treatment also applies for the purposes of the newly introduced "available-for-use" rules in section 13 -- in particular for the two-year rolling start rule in new paragraphs 13(27)(b) and 28(c) and the special rule for long-term projects in new subsection 13(29).

Paragraph 87(2)(j.6) is also amended to provide that an amalgamated corporation is deemed to be the same corporation as each of its predecessor corporations in respect of reserve claims made pursuant to section 32 of the Act. Section 32 sets out the rules for reserves of insurance brokers and agents with respect to unearned commissions. This amendment ensures that an amalgamated corporation may claim the additional reserve that would have been available to a predecessor corporation under new subsection 32(3).

The amendment to paragraph 87(2)(j.6) applies with respect to amalgamations occurring and, pursuant to paragraph 88(1)(e.2) of the Act, windings-up commencing after 1989.

Subclause 65(5)

ITA
87(2)(m)

Paragraph 87(2)(m) of the Act provides that, for the purpose of computing the income of a corporation formed as a result of an amalgamation for a taxation year, any amount claimed by a predecessor corporation as a capital gain reserve under subparagraph 40(1)(a)(iii) for its last taxation year is to be treated as having been claimed by the new corporation for a taxation year immediately preceding its fiscal taxation year and to be the amount determined under subparagraph 40(1)(a)(i) in respect of that property. Paragraph 87(2)(m) is amended to provide equivalent treatment in respect of a reserve claimed by a predecessor corporation under the rules relating to replacement properties in subparagraph 44(1)(e)(iii) of the Act for its last taxation year ending before the amalgamation.

This amendment is applicable to amalgamations occurring and, pursuant to paragraph 88(1)(e.2), windings-up commencing after 1989.

Subclause 65(6)

ITA
87(2)(y)

The addition of new paragraph 87(2)(y) of the Act treats the new corporation formed on an amalgamation to be the continuation of its predecessor corporations for the purpose of the rules in subsections 84(1) and (10) relating to the computation of paid-up capital after July 13, 1990.

Subclause 65(7)

ITA
87(2)(z.1)

Paragraph 87(2)(z.1) of the Act provides rules for computing the capital dividend account of a new corporation formed as a result of an amalgamation and accordingly determines the amount of capital dividends that can be paid by the new corporation to its shareholders. Paragraph 88(1)(e.2) of the Act applies this provision to windings-up.

The amendment to paragraph 87(2)(z.1), which applies to the computation of capital dividend accounts for amalgamations occuring after July 13, 1990, treats the new corporation formed on an amalgamation to be the same corporation for the purpose of computing the new corporation's capital dividend account. The purpose of this amendment is to ensure that a "negative balance" in a predecessor corporation's capital dividend account (that is, deductions that are in excess of the additions made in computing that corporation's account before the amalgamation) flows through to the new corporation, thereby preventing an overstatement of its capital dividend account and an overpayment of tax-free capital dividends. The rule will continue to prohibit a flow-through of a predecessor corporation's capital dividend account where subsection 83(2.1) of the Act would have applied to restrict that corporation's ability to pay capital dividends to its shareholders.

Subclause 65(8)

ITA
87(2)(bb)

Paragraph 87(2)(bb) of the Act provides rules that apply in calculating the capital gains dividend account and refundable capital gains tax on hand of a mutual fund corporation formed as result of an amalgamation. Two amendments are being made to this paragraph.

The first amendment extends the rules in paragraph 87(2)(bb) to investment corporations that are not also mutual fund corporations. The second amendment provides that the amounts determined under subparagraphs 131(6)(b)(i) and (ii) and (d)(i) and (ii) of the Act in respect of a predecessor mutual fund corporation or investment corporation will be added to the amounts determined under those provisions for the new corporation. As a result, the new corporation will continue to carry any positive or negative balance in the accounts of a predecessor mutual fund corporation or investment corporation immediately before the amalgamation. The amendments to paragraph 87(2)(bb) are applicable to amalgamations occurring after July 13, 1990 and, where the taxpayer notifies the Minister of National Revenue before 1993, to amalgamations occurring after 1986.

Subclause 65(9)

ITA
87(2)(ll)

Paragraph 87(2)(ll) of the Act provides that, for the purpose of computing the amount of any reserve under paragraph 20(1)(n) in respect of a property sold in the course of business or under subparagraph 40(1)(a)(iii) in respect of a disposition of a capital property, a corporation formed as a result of an amalgamation shall be deemed to be the same corporation as and a continuation of the amalgamating corporation which sold or disposed of the property. This amendment adds a reference to subparagraph 44(1)(e)(iii) of the Act in subparagraph 87(2)(ll)(ii), and is intended to treat an amalgamated corporation in the same manner as its predecessor corporation for the purpose of computing any reserve available under the rules relating to replacement properties in subparagraph 44(1)(e)(iii) in respect of a property disposed of by the predecessor.

This amendment is applicable to amalgamations occurring and, pursuant to paragraph 88(1)(e.2), windings-up commencing after 1989.

Subclause 65(10)

ITA
87(4.2)

Subsection 87(4.2) of the Act treats preferred shares issued on an amalgamation, in exchange for substantially similar shares issued by a predecessor corporation, as having been issued at the same time and under the same circumstances as the shares issued by the predecessor corporation. New paragraph 87(4.2)(f), which applies to the 1988 and subsequent taxation years, provides that a new share issued on an amalgamation in exchange for a share of a predecessor corporation is, for the purposes of paragraphs 191(4)(d) and (e) of the Act, to be treated as having been issued for the same consideration, to be the same share and to have been issued for the same purpose, as the exchanged share. This new paragraph also provides that where the new shares are the only consideration received for the exchanged shares, the "specified amount" in respect of the new shares will, for the purpose of subsection 191(4), be determined by reference to the fair market value of the exchanged share or the consideration for which the exchanged share was issued. New paragraph 87(4.2)(f) is intended to exempt certain dividends paid on such new shares from tax under Parts IV.1 and VI.1 of the Act where the "specified amount" in respect of the exchanged share under subsection 191(4) did not exceed its fair market value and the same amount is specified in respect of the new share.

Subclause 65(11)

ITA
87(4.4)

Under the existing flow-through share rules, a corporation formed as a consequence of an amalgamation may not renounce resource expenditures incurred by it after the amalgamation pursuant to a flow-through share agreement entered into before the amalgamation. New subsection 87(4.4) of the Act is introduced so renunciations of such resource expenditures will generally not be restricted as a consequence of an amalgamation under section 87 of two or more corporations (referred to herein as a "predecessor corporations") each of which was a principal-business corporation (within the meaning assigned by paragraph 66(15)(h)) or a corporation that had never carried on business.

Subsection 87(4.4) applies where a predecessor corporation issued a flow-through share before an amalgamation and the terms and conditions of the new share issued in lieu of the flow-through share on the amalgamation are the same as, or substantially the same as, the terms and conditions of the flow-through share. The new rule also applies where the predecessor corporation merely granted a right to have a flow-through share issued and the new share, to be issued by the amalgamated corporation in lieu of such right, is not a share prescribed under paragraph 66(15)(d.1) (Part LXII of the Regulations prescribes shares for this purpose).

This amendment is applicable after February, 1986.

Subclause 65(12)

ITA
87(9)

Subsection 87(9) of the Act provides rules dealing with an amalgamation of two or more corporations in which shares of the corporation controlling those corporations are issued to the predecessor corporations' shareholders. New paragraphs 87(9)(a.1) and (a.2), which apply to amalgamation and mergers occurring after 1986, are intended to clarify that subsections 87(4.1) to (4.3) - which operate to extend the "grandfathering" applicable to certain shares that are exchanged for similar shares issued on an amalgamation - will also be available in respect of shares issued on an amalgamation to which subsection 87(9) applies.

Clause 66

Windings-up

ITA
88

Section 88 of the Act deals with the tax consequences arising on the winding-up of a corporation. Subsection 88(1) provides rules which apply where a subsidiary has been wound-up into its parent, provided that both corporations are taxable Canadian corporations and the parent owns not less than 90% of the issued shares of each class of the subsidiary's capital stock.

Subclause 66(1)

ITA
88(1)(a)(ii)

Subparagraph 88(1)(a)(ii) of the Act provides that any eligible capital property of a subsidiary is deemed to have been disposed of on its winding-up for proceeds equal to twice the cost amount to the subsidiary of the property immediately before the winding-up. The purpose of this rule is to treat such property as having been disposed of for an amount that produces neither income nor loss to the subsidiary. To preserve this rollover treatment, subparagraph 88(1)(a)(ii) is amended, applicable to distributions made on the winding-up of a subsidiary in taxation years of the subsidiary commencing after June 1988, to treat the subsidiary's proceeds of disposition of eligible capital property to be 4/3 of the cost amount to the subsidiary of such property immediately before the winding-up. This amendment reflects the increase, for taxation years of corporations commencing after June 30, 1988, in the inclusion rate for eligible capital property from 1/2 to 3/4.

Subclause 66(2)

ITA
88(1)(a.2)

Subsection 88(1) of the Act treats the property, other than a partnership interest, of a subsidiary corporation that is distributed to its parent corporation on a winding-up of the subsidiary as having been disposed of by the subsidiary for proceeds of disposition that generally result in a tax-deferred transfer or "rollover" of the property to the parent corporation.

Paragraph 88(1)(a.2) provides that a partnership interest distributed to the subsidiary's parent on the winding-up will be treated as not having been disposed of by the subsidiary on the winding-up. Instead, paragraph 87(2)(e.1) of the Act, which applies to windings-up under subsection 88(1) by reason of paragraph 88(1)(e.2), will treat the parent as the same corporation as and a continuation of the subsidiary so that the cost of the partnership interest to the subsidiary, as well as any adjustments required to be made in computing the adjusted cost base to the subsidiary of the partnership interest, will be taken into account in computing any gain or loss from a subsequent disposition of the partnership interest by the parent corporation.

The amendment to paragraph 88(1)(a.2) provides an exception, for the purposes of paragraph 98(5)(g), from the rule that a subsidiary's partnership interest will not be considered to have been disposed of on its winding-up. The purpose of this exception is to provide that, where the parent and its subsidiary were the only members of a partnership and subsection 98(5) otherwise applies, the subsidiary will be treated for the purposes of paragraph 98(5)(g) as having disposed of its partnership interest and the parent will be eligible for an addition to the cost base of certain property received by it on the dissolution of the partnership. This amendment is applicable with respect to windings-up commencing after January 15, 1987.

Subclause 66(3)

ITA
88(1)(c)(ii)

Subsection 88(1) of the Act sets out detailed rules dealing with the winding-up of a taxable Canadian corporation into a parent corporation that owns at least 90 per cent of its shares. Paragraph 88(1)(a) of the Act determines the proceeds of disposition to the subsidiary of any property that was distributed to the parent on the winding-up. The amount of the proceeds of disposition of a property to the subsidiary under paragraph 88(1)(a) is also used in determining the cost of that property to the parent corporation under paragraph 88(1)(c). In the case of a property of the subsidiary that is not a Canadian or foreign resource property, an eligible capital property or an interest in a partnership, subparagraph 88(1)(a)(iii) treats the proceeds of disposition of the property to the subsidiary as being equal to the cost amount of that property to the subsidiary immediately before the winding-up.

Subsection 80(1) of the Act is intended to apply in certain circumstances where a debt owing by a subsidiary to its parent is settled or extinguished on a winding-up for less than its principal amount. The resulting gain reduces, in turn, the amount of the subsidiary's deductible loss carry-overs from preceding taxation years, the capital cost of its depreciable property and the adjusted cost base of any other capital property. Since the subsidiary's proceeds of disposition of a property and the parent's cost of the property is determined on the basis of the cost amount of that property to the subsidiary immediately before the winding-up, it may be contended that the reductions in the cost amount of the property to the subsidiary required to be made under paragraph 80(1)(b) on the winding-up are not reflected in the cost amount of the property to the parent.

Subparagraph 88(1)(c)(ii) is amended, applicable to windings-up commencing after July 13, 1990, to clarify that the cost amount to the parent of a property distributed to the parent by the subsidiary on its winding-up reflects any reductions of the cost amount to the subsidiary of the property required to be made under paragraph 80(1)(b) on the winding-up.

Subclause 66(4)

ITA
88(1)(d)

Subsection 88(1) of the Act sets out detailed rules relating to the winding-up of a subsidiary into a parent corporation that owns at least 90% of its shares. On a winding-up of such a subsidiary, paragraphs 88(1)(c) and (d) permit the parent to increase the cost base of certain non-depreciable capital property owned by the subsidiary in circumstances where the adjusted cost base of the parent's shares in the subsidiary exceeds the net tax value of the subsidiary's assets. This increase in the cost base under paragraph 88(1)(d) does not apply to depreciable property nor to assets acquired by the subsidiary as a result of a transfer to it of property in the course of a "butterfly reorganization" described in paragraph 55(3)(b) of the Act.

New paragraph 88(1)(d) amends the exception for butterfly reorganizations by providing that a cost base increase is not available with respect to property transferred to a subsidiary in the course of a reorganization described in paragraph 55(3)(b) where, in order to effect the direct or indirect transfer of the property to the parent as required by paragraph 55(3)(b), the subsidiary was wound-up. Therefore, property which was the subject of a previous butterfly reorganization may qualify under paragraph 88(1)(d). For example, where an arm's length purchaser acquires for fair market value the shares of a subsidiary that owns non-depreciable capital property which was the subject of a previous butterfly reorganization, the purchaser corporation, on a subsequent winding-up of the subsidiary, may be entitled to an increase in the cost base of that property of the subsidiary distributed to it on the winding-up. This amendment applies with respect to windings-up commencing after September, 1988.

New paragraph 88(1)(d) also provides that an increase in cost base will not be available with respect to property transferred to a subsidiary by the parent or by any person or partnership that was not, otherwise than by reason of a right referred to in paragraph 251(5)(b) of the Act, dealing at arm's length with the parent. Therefore, property transferred to a corporation by a subsequent purchaser of the corporation will not qualify for this increase on the winding-up of the corporation into the purchaser. This amendment applies to windings-up commencing after July 13, 1990.

Subclause 66(5)

ITA
88(1)(d)(i)

Clause 88(1)(d)(i)(C) of the Act provides that, for the purpose of computing the amount by which the cost of certain capital property of a subsidiary may be increased on a winding-up of the subsidiary into its parent, any reserve referred to in paragraph 20(1)(n), subparagraph 40(1)(a)(iii) or section 64 that was deducted in computing the subsidiary's income for the year in which it was wound-up is not to be deducted from the cost amount of the subsidiary's property (or the amount of any money on hand). The parent corporation, is, however, entitled to claim any such reserve to the extent that the subsidiary would have been permitted to do so had the winding-up not occurred.

This amendment, which applies to windings-up commencing after 1989, provides that reserves claimed under subparagraph 44(1)(e)(iii) of the Act are also not to be deducted under clause 88(1)(d)(i)(C). Pursuant to an amendment to paragraph 87(2)(ll) of the Act, the parent corporation will, instead, be entitled to claim a reserve under the rules relating to replacement properties in subparagraph 44(1)(e)(iii) in respect of a disposition of property by its subsidiary.

Subclause 66(6)

ITA
88(1)(d)(i.1)

Subparagraph 88(1)(d)(i.1) of the Act limits the amount by which the cost of certain capital property of a subsidiary may be increased on a winding-up where the parent corporation or a corporation with which the parent was not dealing at arm's length has received particular types of dividends on shares of the subsidiary. This amendment, which applies to windings-up commencing after 1986, provides that in determining for the purposes of subparagraph 88(1)(d)(i.1) whether a corporation deals at arm's length with the parent corporation, a right referred to in paragraph 251(5)(b) of the Act in respect of the subsidiary may be ignored.

Subclause 66(7) and (8)

ITA
88(1)(e.2)

Under paragraph 88(1)(e.2) of the Act, many of the rules which apply on the winding-up of a subsidiary into its parent are established by reference to specific provisions in section 87 of the Act dealing with corporate amalgamations. This paragraph is amended, applicable to windings-up ending after June 18, 1987, to delete the reference to paragraph 87(2)(e.2) which applies to certain properties used or held by a predecessor corporation in the course of carrying on the business of insurance or lending money. This reference is not required since subparagraphs 88(1)(a)(iii) and (c)(ii) of the Act provide the rules that apply on a winding-up to properties described in paragraph 87(2)(e.2).

This paragraph is also amended, as a consequence of an amendment to paragraph 87(2)(z.1) of the Act, by repealing subparagraphs 88(1)(e.2)(xi) and (xii). This latter amendment, which relates to the capital dividend account of a subsidiary, applies to the computation of such accounts for windings-up commencing after July 13, 1990.

Subclause 66(9)

ITA
88(1)(e.8)

Paragraph 88(1)(e.8) of the Act provides that, for the purposes of determining a parent corporation's eligibility for certain investment tax credits and for the one-month extension of the date on which the balance of its tax under Part I of the Act is due, the taxable income and business limit of its subsidiary, for the taxation year in which its assets were transferred to the parent on a winding-up, are to be included in the taxable income and business limit of the parent. This paragraph is amended, applicable to windings-up commencing after May 23, 1985, to replace the reference therein to paragraph 127.1(2)(a) with a reference to the definition "qualifying corporation" in subsection 127.1(2), in order to reflect amendments made to that subsection as of that date.

Subclause 66(10)

ITA
88(1.1)(b)

Subsection 88(1.1) of the Act permits a parent corporation to claim the non-capital losses, restricted farm losses, farm losses and limited partnership losses of a subsidiary that has been wound up if the parent owned at least 90 per cent of the subsidiary's issued shares. Paragraph 88(1.1)(b) stipulates that the only losses that flow through to the parent corporation are those that the subsidiary itself could have deducted in its first taxation year commencing after the commencement of the winding-up. Thus a loss which was no longer available to a subsidiary by reason of the expiry of the carry forward period under section 111 of the Act or because it was claimed by the subsidiary under Part IV of the Act may not be utilized by the parent following the winding-up.

Since non-capital losses and other loss carryovers may not be deducted in the taxation years in which they arise, the rule in paragraph 88(1.1)(b) denies the flow-through of the losses of a subsidiary which arise before the completion of the winding-up, but during the subsidiary's first taxation year beginning after the winding-up. In order to allow such losses to be used by a parent corporation, paragraph 88(1.1)(b) is amended, effective for the 1985 and subsequent taxation years, to apply to losses that would otherwise have been deductible by the subsidiary in any taxation year following the winding-up.

This amendment also clarifies that where the losses of a subsidiary become available to its parent corporation following the winding-up of the subsidiary, those losses will again be flowed through on a subsequent winding-up of the parent into its parent corporation.

Subclause 66(11)

ITA
88(1.1)(e)

Where control of a parent or subsidiary corporation has been acquired, special rules in paragraph 88(1.1)(e) of the Act apply to restrict the amount that the parent may deduct following the winding-up of the subsidiary in respect of losses of the subsidiary incurred before the acquisition of control. This provision is amended to clarify, together with the other amendments to subsection 88(1.1) described above, that where, following a winding-up the losses of a subsidiary become available to its parent, those losses will again be flowed through on a subsequent winding-up of the parent into its parent corporation. However, to the extent that the deductibility of those losses was limited by paragraph 88(1.1)(e) following the first winding-up, this paragraph will now ensure that the same limitations apply following the subsequent winding-up in computing taxable income for the 1990 and subsequent taxation years.

Subclause 66(12)

ITA
88(1.1)(f)

Where there has been a winding-up of a subsidiary corporation, subsection 88(1.1) of the Act treats the deductible non-capital losses, restricted farm losses, farm losses and limited partnership losses of the subsidiary as losses of its parent corporation for the taxation year of the parent in which the subsidiary's loss year ended. This amendment provides that, where this rule applies to deem a subsidiary's loss to be a loss of the parent for a taxation year of the parent commencing after the commencement of the winding-up, the parent may elect to treat the loss as having arisen in its preceding taxation year. This election, which may be made in respect of the 1985 and subsequent taxation years, would be made by a parent corporation in order to enable it to deduct the loss in computing taxable income for its taxation year in which the subsidiary's loss year ended.

Subclause 66(13)

ITA
88(1.2)

Subsection 88(1.2) of the Act allows a parent corporation to utilize the net capital losses of a subsidiary corporation which has been wound up if the parent owned at least 90% of the subsidiary's issued shares. This provision is amended, effective for the 1985 and subsequent taxation years, to parallel the changes proposed to subsection 88(1.1) of the Act which provides a similar flow-through for non-capital losses, restricted farm losses, farm losses and limited partnership losses.

These changes provide that:

- where net capital losses are incurred by a subsidiary in its first taxation year commencing after the commencement of the winding-up, those losses may be utilized by its parent corporation

- where net capital losses of a subsidiary become available to a parent corporation following the winding-up of the subsidiary, those losses will be flowed through on a subsequent winding-up of the parent into its parent corporation

- where under subsection 88(1.2) a net capital loss of a subsidiary would be treated as a loss of its parent for a taxation year commencing after the commencement of the winding-up, the parent may elect to treat the loss as being its loss for the immediately preceding year.

For further information, reference may be made to the commentary describing the parallel amendments to subsection 88(1.1) of the Act.

Subclause 66(14)

ITA
88(1.6)

New subsection 88(1.6) of the Act provides rules that apply where a subsidiary corporation that calculates its income under the cash method is wound up in circumstances to which subsection 88(1) applies.

First, new subsection 88(1.6) treats the cost amount of purchased inventory of the subsidiary immediately before it is wound up to be the aggregate of two amounts. The first amount is the proportion of the amount that would have been included under paragraph 28(1)(c) of the Act in computing the subsidiary's income if its taxation year had ended at the time of the winding-up that the value of the purchased inventory being distributed to the parent is of the value of all purchased inventory owned by the subsidiary at that time. The second amount is such additional amount as the subsidiary may elect, not exceeding the excess of the fair market value of the inventory over the first amount described above. The purpose of this amendment, in part, is to ensure that the winding-up of a corporation will not avoid the application the mandatory inventory adjustment under paragraph 28(1)(c).

Second, new subsection 88(1.6) provides that the subsidiary will be treated as having received, and a parent that calculates its income under the cash method will be treated as having paid, an amount equal to the cost amount of the inventory distributed to the parent. These amendments ensure that the subsidiary will include this amount in its income under paragraph 28(1)(a) of the Act and that the parent will be able to deduct the same amount under paragraph 28(1)(e) of the Act.

These amendments apply to windings-up commencing after July 13, 1990.

Subclauses 66(15) and (17)

ITA
88(2)

Subsection 88(2) of the Act provides rules relating to the computation and distribution of the capital dividend account, capital gains dividend account (in the case of a non-resident owned investment corporation) and pre-1972 capital surplus on hand of a Canadian corporation that is wound up in circumstances to which subsection 88(1) does not apply. The amendments to paragraphs 88(2)(a) and (b) of the Act, which apply to windings-up commencing after 1988, extend the application of the rules currently provided in subsection 88(2) to the capital gains dividend account of investment corporations and are intended to ensure that such accounts may be distributed as capital gains dividends to shareholders of an investment corporation that is wound up.

Subclauses 66(16) and (18)

ITA
88(2)

Subsection 88(2) of the Act applies to a winding-up of a Canadian corporation to which subsection 88(1) does not apply. Subparagraph 88(2)(a)(vi) provides that paragraph 12(1)(t) of the Act, which requires investment tax credits claimed in preceding taxation years to be included in computing a taxpayer's income to the extent that they have not been applied to reduce the tax basis of the related expenditure, is to also apply in respect of investment tax credits claimed by the corporation in the year in which all or substantially all of its property is distributed on a winding-up.

Subparagraph 88(2)(a)(vi) is repealed, applicable after 1987, and re-enacted as new paragraph 88(2)(c) in order to clarify that it applies for the purposes of computing the corporation's income and not for the purposes of computing the corporation's capital dividend account, capital gains dividend account or pre-1972 capital surplus on hand.

Subclause 66(19)

ITA
88(3)

Subsection 88(3) provides that shares of a foreign affiliate of a taxpayer that are transferred to the taxpayer on the dissolution of a controlled foreign affiliate of the taxpayer will be considered to have been disposed of by the controlled foreign affiliate, and to have been acquired by the taxpayer, for any amount elected by the taxpayer that is between the adjusted cost base and the fair market value of the shares. The taxpayer's proceeds of disposition of the controlled foreign affiliate's shares are equal to the amount by which the elected amount and any non-share consideration received on the disposition exceeds any debts of the controlled foreign affiliate that were assumed or cancelled by the taxpayer on the dissolution.

Subsection 88(3) is amended, applicable to dissolutions occurring after July 13, 1990, to ensure that dividends owing to the taxpayer, or to a person with whom the taxpayer was not dealing at arm's length, by the controlled foreign affiliate at the time of the dissolution will not reduce the taxpayer's proceeds of disposition of the controlled foreign affiliate's shares.

Subclause 66(20)

ITA
88(4)

Subsection 88(4) of the Act provides special rules for determining whether control of a corporation has been acquired for the purposes of paragraphs 88(1)(c) and (d). Paragraphs 88(1)(c) and (d) apply in certain circumstances to allow a parent corporation to increase the adjusted cost base of non-depreciable capital property acquired from a subsidiary corporation on a winding-up of the subsidiary. This increase is available only in respect of property that was owned by the subsidiary since the parent last acquired control of the subsidiary.

Subsection 88(4) currently provides that, in determining whether control of a corporation has been acquired, control shall not be treated as having been acquired by reason of an amalgamation and any corporation formed as a result of an amalgamation of two or more predecessor corporations is to be treated as the same corporation as and a continuation of the predecessor corporations. In the case of a subsidiary formed as a result of an amalgamation, the effect of the rules in subsection 88(4) is to treat the relevant holding period as commencing at the time the parent acquired control of the predecessor. Subsection 88(4), however, applies only for the purposes of determining whether control of a corporation has been acquired and not for the purposes of determining whether property was owned by the subsidiary throughout the relevant period. The amendment to subsection 88(4), which applies to windings-up commencing after March 31, 1977, provides that the rules in that subsection apply generally for the purposes of paragraphs 88(1)(c), (d) and (d.2) and not only for the purposes of determining whether control of a corporation has been acquired.

Clause 67

Definitions Relating to Corporations

ITA
89

Section 89 of the Act defines certain terms that apply in relation to corporations resident in Canada and their shareholders.

Subclauses 67(1) and (2)

ITA
89(1)(b)

"capital dividend account"

Paragraph 89(1)(b) of the Act defines the "capital dividend account" of a corporation. Where a corporation has elected to pay a dividend out of its capital dividend account, the dividend is not subject to tax in the hands of a shareholder resident in Canada.

A corporation's capital dividend account excludes that portion of any capital gain that accrued in respect of a property while it was a property of a corporation that was not a private corporation or a corporation described in section 130, 130.1 or 131 of the Act and, in certain circumstances, that accrued while the property was a property of a corporation controlled by non-residents or a corporation exempt from tax under Part I of the Act. Paragraph 89(1)(b) currently provides that gains that accrued on "designated property", which is essentially property owned by a corporation prior to November 13, 1981, are not subject to these exclusions. The definition "capital dividend account" is amended, for taxation years ending after November 26, 1987, to provide that capital gains in respect of dispositions of designated property will be excluded in calculating a corporation's capital dividend account to the extent that the gain accrued while the property was owned by a corporation controlled by non-residents or by an exempt corporation.

Subclause 67(3)

ITA
89(1)(c)

"paid-up capital"

Subparagraph 89(1)(c)(ii) of the Act defines "paid-up capital" in respect of a class of shares of the capital stock of a corporation. Due to the special attributes of shares of certain cooperative corporations and credit unions, the definition of paid-up capital may be difficult to apply in the case of such shares. In conjunction with the amendment to the definition of "share" in subsection 248(1) of the Act, subparagraph (ii) of the definition of "paid-up capital" is therefore amended, applicable after 1988, to provide that where the statute under which a cooperative corporation or credit union was incorporated does not provide for the concept of paid-up capital in respect of a class of shares, the paid-up capital of that class is to be treated as being the aggregate of all amounts received less amounts repaid by the corporation in respect of shares of that class issued and outstanding at the time of computation.

Subclause 67(4)

ITA
89(1)(f)

"private corporation"

Paragraph 89(1)(f) of the Act defines the term "private corporation" which, by virtue of subsection 248(1), has application for all purposes of the Act.

Two amendments are being made to this paragraph, applicable after July 13, 1990. The first amendment provides that a corporation that is controlled by one or more federal Crown corporations prescribed under section 7100 of the Regulations or by a combination of public corporations and prescribed federal Crown corporations will not qualify as a private corporation. The second amendment provides that a public corporation that is a venture capital corporation prescribed under section 6700 of the Regulations will not be included as a public corporation for the purposes of this paragraph.

Clause 68

Income from Foreign Affiliates

ITA
91(6)

Where a taxpayer resident in Canada has received a dividend on a share out of the taxable surplus of a controlled foreign affiliate, subsection 91(5) of the Act permits a deduction, from the amount that would otherwise be included in computing the taxpayer's income in respect of the dividend, in respect of the previously taxed foreign accrual property income that was added to the adjusted cost base of the share.

New subsection 91(6) applies with respect to the shares of a foreign affiliate acquired by a taxpayer that is a taxable Canadian corporation from another corporation resident in Canada with which the taxpayer was not dealing at arm's length. This new subsection provides that, for the purposes of subsection 91(5) of the Act, any amount of foreign accrual property income required to be added or deducted to the adjusted cost base to the other corporation of such shares is to be treated as having been added or deducted in computing the adjusted cost base to the taxpayer of the shares. As a result, where the taxpayer receives a dividend out of the taxable surplus of the foreign affiliate, the taxpayer will be able to deduct from that dividend an amount representing the foreign accrual property income of the foreign affiliate that was previously taxed in the hands of the other corporation from which it acquired the shares. New subsection 91(6) applies to the 1990 and subsequent taxation years.

Clause 69

Disposition of Shares of Foreign Affiliates

ITA
93

Section 93 of the Act contains a number of rules relating to the disposition by a corporation of shares of a foreign affiliate.

Subclause 68(1)

ITA
93(1)

Subsection 93(1) of the Act permits a corporation resident in Canada to treat a portion of the proceeds from the disposition of a share of a foreign affiliate by it or another foreign affiliate as a dividend. The dividend is treated as having been received, immediately before the disposition, from the affiliate by the disposing corporation or disposing affiliate and reduces that corporation's proceeds of disposition.

The amendments to subsection 93(1) are being made in conjunction with amendments to subsection 40(3) of the Act to allow a corporation resident in Canada to elect to treat a portion of the gain arising under subsection 40(3) as a dividend. Subsection 40(3) will apply to a share of a foreign affiliate whenever the adjusted cost base of the share has, as a result of the adjustments required under subsection 53(2) of the Act, been reduced below nil. This "negative" adjusted cost base is treated as a capital gain of the holder of the share and, as a result of amendments to subsection 40(3), is treated as being proceeds of disposition of the share for the purposes of subsection 93(1).

New paragraph 93(1)(b) applies whenever the disposing corporation or the disposing affiliate is treated as having realized a gain under subsection 40(3) on a share of a foreign affiliate. New subparagraph 93(1)(b)(i) provides that any amount which the corporation elects to treat as a dividend and not as proceeds of disposition will reduce the amount of the gain. In order to ensure that the adjusted cost base of the share is returned to nil this reduction will not apply for the purposes of paragraph 53(1)(a) which adds the gain under subsection 40(3) in determining the adjusted cost base of the share.

New subparagraph 93(1)(b)(ii) provides that the affiliate will be considered to have redeemed shares of a class of its capital stock for the purposes of calculating certain of its accounts in respect of the corporation resident in Canada. This amendment ensures that the exempt surplus, exempt deficit, taxable surplus, taxable deficit and underlying foreign tax in respect of the corporation resident in Canada are appropriately reduced under subsection 5905(2) of the Regulations to reflect the portion of these accounts that is utilized as a result of the payment of the dividend to the disposing corporation.

The amendments to subsection 93(1) apply to the 1987 and subsequent taxation years.

Subclause 69(2)

ITA
93(2)

Subsection 93(2) of the Act reduces the amount of the capital loss that would otherwise arise from the disposition by a Canadian corporation or a foreign affiliate of a Canadian corporation ("the disposing corporation") of a share of a foreign affiliate of the Canadian corporation. This reduction is equal to the amount of all exempt dividends received by the disposing corporation from the affiliate on that share prior to the disposition. Two amendments are being made to subsection 93(2).

The first amendment, which applies to the 1985 and subsequent taxation years, provides that subsection 93(2) applies in determining the loss, rather than the capital loss, of the disposing corporation. This amendment is consequential on the changes to subsection 112(4) of the Act which provide that, in respect of corporate shareholders, only taxable dividends deductible under section 112 or subsection 115(1) or 138(6) will reduce the amount of a loss on a share that is not a capital property.

The second amendment to subsection 93(2), which applies to dispositions of shares occurring after July 13, 1990, ensures that subsection 93(2) operates effectively when shares of a foreign affiliate have been transferred within a corporate group. As amended, subsection 93(2) will apply to reduce the capital loss of a disposing corporation on a share of a foreign affiliate by all prior exempt dividends previously received on that share or a share for which it was substituted by the disposing corporation, any related corporation or any foreign affiliate of the disposing corporation or of a related corporation. In order to ensure that exempt dividends received on a share do not reduce losses in respect of that share more than once, the amount required to be deducted in computing the loss of the disposing corporation in respect of a share under subsection 93(2) will be reduced by any previous reduction under that subsection in respect of a loss from a previous disposition of that share by any other corporation within the group described above.

Subclause 69(3)

ITA
93(4)

Subsection 93(4) of the Act applies where a Canadian taxpayer or a foreign affiliate of a Canadian taxpayer (the "vendor") has acquired shares of a foreign affiliate (the "acquired affiliate") on the disposition of shares of another foreign affiliate. In such circumstances, any capital loss realized by the vendor is denied and added to the adjusted cost base to the vendor of the shares of the acquired affiliate. The loss limitation rule in subsection 93(2), which reduces any loss of the vendor by exempt dividends previously received on the shares by the vendor and certain other corporations, may also apply in these circumstances and the effect of the rule in subsection 93(4) is to override subsection 93(2) and to add any loss denied under that latter subsection to the adjusted cost base to the vendor of the shares of the acquired affiliate.

Subsection 93(4) is amended, for dispositions of shares occurring after July 13, 1990, to provide that the amount to be added to the adjusted cost base to the vendor of the acquired corporation's shares is equal to the amount by which the total of all capital losses realized by the vendor on the disposition of the shares of the other affiliate exceeds the amounts required to be deducted from those losses under subsection 93(2). This ensures that only that portion of a capital loss realized by the vendor on a share that is not attributable to exempt dividends, as defined in subsection 93(3), received on that share will be added to the adjusted cost base to the vendor of the acquired affiliate's shares.

Clause 70

Non-resident Trusts

ITA
94(1)(b)(i)

Section 94 of the Act provides for special rules to tax the passive income earned by certain trusts that are not resident in Canada. In the case of trusts under which the amount of the income or capital to be distributed to beneficiaries does not depend on the exercise of discretion, the rules parallel the foreign accrual property income rules in respect of non-resident corporations.

One of the circumstances under which the rules in section 94 may apply is where a non-resident trust has acquired property from a beneficiary or a specified relation to a beneficiary. However, the rules will not apply in this circumstance in respect of a taxation year where the transferor of such property is an individual who has been resident in Canada for 60 months or less before the end of the year.

Section 94 is amended for the 1990 and subsequent taxation years so that the rules provided therein do not apply in respect of a trust governed by a foreign retirement arrangement, as newly defined in subsection 248(1). Thus, where this new exclusion applies, relief from the application of the rules in section 94 may be provided even where a beneficiary has been resident in Canada for more than 60 months.

Clause 71

Definitions

ITA
95

Section 95 of the Act defines a number of terms and provides certain rules that apply for the purposes of the rules in subdivision i of Division B in Part I of the Act relating to shareholders of non-resident corporations.

Subclause 71(1)

ITA
95(1)(a)

"controlled foreign affiliate"

Paragraph 95(1)(a) of the Act defines "controlled foreign affiliate" of a taxpayer as a foreign affiliate of the taxpayer that was controlled by the taxpayer, the taxpayer and not more than four other persons resident in Canada or a related group of which the taxpayer was a member. A related group may not be considered to control a corporation where one member of that group controls the corporation alone. As a result, the definition of controlled foreign affiliate is being amended, applicable to taxation years commencing after July 13, 1990, to remove the concept of a related group. This amendment provides that a foreign affiliate of a taxpayer will be a controlled foreign affiliate of that taxpayer where it is controlled by a person or persons with whom the taxpayer does not deal at arm's length, by the taxpayer and such a person or persons or by not more than four persons resident in Canada other than the taxpayer.

Subclause 71(2)

ITA
95(1)(a.1)

"excluded property"

Taxable capital gains and allowable capital losses from dispositions of excluded property of a foreign affiliate of a Canadian taxpayer are generally not included in the affiliate's foreign accrual property income. Paragraph 95(1)(a.1) of the Act defines "excluded property" of a foreign affiliate of a Canadian taxpayer as property used by the affiliate in an active business and shares of other foreign affiliates of the taxpayer all or substantially all of the property of which is excluded property.

A special rule in paragraph 95(1)(a.1) applies to treat a partnership interest of a foreign affiliate as excluded property where the fair market value of that interest is 10% or more of the value of all interests in the partnership and all or substantially all of the property of the partnership is excluded property. This rule treats the partnership as a foreign affiliate and the interest in the partnership as shares of that affiliate. This rule, however, applies only for the purposes of the excluded property definition and not for the purposes of determining whether a non-resident corporation whose shares are owned by a partnership is a foreign affiliate of the taxpayer. As a result, where a foreign affiliate of a taxpayer owns an interest in a partnership that, in turn, owns shares in a non-resident corporation, that non-resident corporation will not be a foreign affiliate of the taxpayer and its shares will not qualify as excluded property of the partnership.

The amendment to paragraph 95(1)(a.1), which applies after 1989, provides that where a foreign affiliate of a taxpayer has an interest in a partnership the partnership is to be treated as a corporation resident in Canada with 100 issued shares of a class of its capital stock. The foreign affiliate is considered to own that proportion of those shares that the fair market value of its interest in the partnership is of the fair market value of all such interests. These rules apply for the purposes of applying the definitions foreign affiliate and equity percentage to the excluded property definition. As a result, it will be possible for a non-resident corporation whose shares are held by a partnership to qualify as a foreign affiliate of a taxpayer for the purposes of the excluded property rules.

Subclauses 71(3) and (4)

ITA
95(1)(b)

"foreign accrual property income"

Paragraph 95(1)(b) of the Act defines the "foreign accrual property income" of a foreign affiliate of a taxpayer. Subparagraph 95(1)(b)(i) includes in the foreign accrual property income of an affiliate for a taxation year its incomes for the year from property and businesses other than active businesses unless that income comes within one of the exceptions set out in clauses 95(1)(b)(i)(A) to (C).

Subparagraph 95(1)(b)(i) is amended, applicable to the 1987 and subsequent taxation years, to add a new exception in clause (D). New clause 95(1)(b)(i)(D) will exclude amounts included in the income of the affiliate under subsection 80.4(2) in respect of indebtedness to another foreign affiliate of the taxpayer or of a person resident in Canada with whom the taxpayer does not deal at arm's length. Subsection 80.4(2) imputes an interest benefit to a person (other than a corporation resident in Canada or a partnership each member of which is a corporation resident in Canada) who is either a shareholder of a corporation or connected to a shareholder of a corporation, where by reason of such shareholding that person receives a low or no interest loan from the corporation or certain other corporations or partnerships. By reason of subsection 80.4(8), a person will not be considered to be connected to a shareholder of the corporation where that person is a foreign affiliate of the corporation or a foreign affiliate of a person resident in Canada with which the corporation does not deal at arm's length.

However, where a foreign affiliate of a taxpayer owns shares of another foreign affiliate of the taxpayer and receives a loan from that other affiliate, paragraph 80.4(2)(a) may apply to impute a benefit to the affiliate in its capacity as a shareholder of the other affiliate. New clause 95(1)(b)(i)(D) ensures that a benefit treated as having been received by a particular affiliate under subsection 80.4(2) in respect of indebtedness to another affiliate of the taxpayer or an affiliate of a person resident in Canada with whom the taxpayer does not deal at arm's length will not be included in the particular affiliate's foreign accrual property income. A consequential amendment is made to subparagraph 95(1)(b)(iii) to reflect the new exception in clause (i)(d).

Subclause 71(5)

ITA
95(2)(a)

Subsection 95(2) of the Act sets out certain rules that apply in determining particular components of the foreign accrual property income of a foreign affiliate. Subparagraph 95(2)(a)(ii) treats amounts paid to a foreign affiliate of the taxpayer by another foreign affiliate of the taxpayer or any non-resident corporation with which the taxpayer does not deal at arm's length as income from an active business of the foreign affiliate where the amount was deductible in computing the payor corporation's earnings from an active business.

The amendment to subparagraph 95(2)(a)(ii), which applies to the 1987 and subsequent taxation years, extends the same rules for payments to a partnership of which a foreign affiliate is a member. It provides that, where such a payment is made to a partnership of which the foreign affiliate is a member, the foreign affiliate's share of the payment to the partnership will be included in calculating its earnings from an active business.

Subclause 71(6)

ITA
95(2)(b)

Paragraph 95(2)(b) of the Act provides that certain service income of a controlled foreign affiliate of a taxpayer will, under certain circumstances, be treated as income from a business other than an active business. Subparagraph 95(2)(a)(i) includes in the income of an active business of a foreign affiliate of a taxpayer any income that pertains to or is incident to an active business carried on by the affiliate in a country other than Canada.

Paragraph 95(2)(b) is being amended to clarify that, in computing the income from an active business of a controlled foreign affiliate, investment income is to be excluded to the extent that it pertains to or is incident to a business that is treated by that paragraph as not being an active business. This amendment, which is applicable to taxation years commencing after July 13, 1990, also provides that where a controlled foreign affiliate of a taxpayer provides certain services, the provision of such services will be treated as a separate business and any income pertaining to or incident to that business will be income from a business other than an active business.

Subclauses 71(7) and (8)

ITA
95(2)(d.1) and (e.1)

Paragraphs 95(2)(d.1) (foreign mergers) and 95(2)(e.1) (dissolution of a foreign affiliate) provide for the rollover of capital property on a foreign merger or dissolution where certain conditions have been met. One of these conditions is that no gain or loss was recognized by the disposing affiliates under the income tax law of the country in which they were resident. These paragraphs are intended to apply where the merger or dissolution is not taxed in the country where the affiliates reside. Paragraphs 95(2)(d.1) and (e.1) are amended, applicable with respect to mergers occurring and liquidations commencing after 1989, to also apply in circumstances where the country of residence has no income tax law.

Subclause 71(9)

ITA
95(2)(f)

Paragraph 95(2(f) of the Act sets out rules for determining the taxable capital gains and allowable capital losses of a foreign affiliate of a taxpayer. Subparagraph 95(2)(f)(i) requires that such a gain or loss is to be computed in Canadian currency when the gain or loss arises from a disposition of property by a controlled foreign affiliate of the taxpayer that is not excluded property. Subparagraph 95(2)(f)(ii) requires all other gains or losses to be calculated using the calculating currency which is the currency of the country in which the affiliate is resident or such other currency as is reasonable in the circumstances.

Subparagraph 95(2)(f)(i) is amended, applicable with respect to dispositions of property occurring after July 13, 1990, to provide that the Canadian currency will be used on dispositions of shares of a foreign affiliate that are excluded property where the disposition occurs under certain provisions of the Act set out in that subparagraph. The dispositions that will be afforded this treatment involve provisions of the Act that allow a foreign affiliate to transfer the shares of another foreign affiliate at the adjusted cost base of those shares in order to provide a rollover to the disposing affiliate. These provisions are subsection 88(3) dealing with a transfer of shares of an affiliate to a taxpayer on the dissolution of a controlled foreign affiliate of the taxpayer, paragraph 95(2)(c) dealing with an exchange of shares of an affiliate between two other affiliates where shares are received as consideration for the exchange, paragraph 95(2)(d) dealing with an exchange of shares of a foreign corporation by a foreign affiliate on a foreign merger, and paragraph 95(2)(e) involving a disposition of shares of an affiliate to another affiliate on the dissolution of a third affiliate. The effect of the amendment to subparagraph 95(2)(f)(i) is to allow a disposing affiliate to transfers shares of another foreign affiliate under the provisions set out in that subparagraph at their original cost expressed in Canadian currency without having to report a gain or loss arising by reason of changes in value of the calculating currency in relation to the Canadian currency.

Clause 72

Rules Relating to Partnerships

ITA
96

Section 96 of the Act provides general rules for determining the income or loss of a partnership and its members.

Subclauses 72(1) and (2)

ITA
96(2.2)(d)

Where a taxpayer is a member of a partnership, the taxpayer's income or loss in respect of the partnership is generally determined by computing each income or loss of a partnership at the partnership level and allocating the applicable share of such income or loss to the taxpayer. This determination generally allows a partnership to take all relevant deductions at the partnership level before the allocation of amounts of income or loss to partners. As an exception to this rule, the income or loss of a partnership is computed without any deduction for Canadian exploration expense (CEE), Canadian development expense (CDE) or Canadian oil and gas property expense (COGPE). Instead, a partner's share of such deductions may be claimed separately by each partner under the rules as set out in sections 66.1, 66.2 and 66.4 of the Act.

Subsection 96(2.1) generally provides that the losses of a partnership allocated to a limited partner will be deductible by the partner only the extent of the limited partner's at-risk amount (minus investment tax credits allocated to the partner and the partner's share of resource expenditures that are not deductible at the partnership level). Section 66.8 generally limits the deductibility of such resource expenditures to the partner's at-risk amount (minus investment tax credits allocated the partner). For the purposes of both subsection 66.8 and 96(2.1), the at-risk amount of a partner is defined in subsection 96(2.2) (with certain modifications for the purposes of section 66.8 mainly resulting from the later effective date of the rules under that section).

Subsection 96(2.2) is amended to ensure that the entitlement to assistance which results in a reduction in a cumulative CEE, CDE or COGPE does not reduce a limited partner's at-risk amount. The amendment also ensures that "excluded obligations" in relation to a share issued to a partnership by a corporation do not cause a reduction in the at-risk amount of a limited partner. As defined in subsection 6202.1(5) of the Regulations, an "excluded obligation" includes corporate obligations in connection with grants under the Canadian Exploration and Development Incentive Program Act and the Canadian Exploration Incentive Program Act.

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

Subclause 72(3)

ITA
96(3)

Subsection 96(3) of the Act provides rules that apply where a member of a partnership makes an election under certain provisions of the Act for a purpose that is relevant to the computation of the member's income from the partnership. In such a case the election will be valid only if it is made on behalf of all of the members of the partnership and the member had authority to act for the partnership. One of the elections included in subsection 96(3) is the election by a taxpayer under subsection 39(4) to treat all of his Canadian securities as capital property.

Subsection 96(3) is amended, applicable to dispositions occurring after July 13, 1990, to remove the reference to subsection 39(4). As a result, each member of a partnership will elect on his own behalf under subsection 39(4) and the treatment of his share of the gain or loss from a disposition of a Canadian security held by the partnership will depend on whether he has elected under subsection 39(4). Subsection 96(3) is also amended to include elections made under subsection 50(1) in respect of bad debts and shares of bankrupt corporations.

Clause 73

Disposition of Partnership Interest

ITA
98

Section 98 of the Act provides rules relating to the taxation of partnership properties and partnership interests where partnerships cease to exist.

Subclause 73(1)

ITA
98(1)(c)

Paragraph 98(1)(c) of the Act applies to partnership interests where, at the end of a fiscal period of the partnership, the total amount deducted under subsection 53(2) of the Act in computing a taxpayer's adjusted cost base of a partnership interest exceeds the cost to the taxpayer of the interest and the total amount added to that cost under subsection 53(1). In such a case and where the partnership has ceased to exist, the amount of the excess is treated as a gain of the taxpayer for the year from a disposition at that time of that interest.

Paragraph 98(1)(c) is amended, applicable to the 1985 and subsequent taxation years, to clarify that such gains are to be treated as gains of the taxpayer for his taxation year that includes the end of the partnership's fiscal period.

Subclause 73(2)

ITA
98(5)(a)

Subsection 98(5) of the Act contains rules which provide a tax-deferred transfer or "rollover" of a Canadian partnership's property where the partnership has ceased to exist and the transfer is to one member of the partnership who continues to carry on the business of the partnership as a sole proprietorship.

Paragraph 98(5)(a) provides for the determination of the continuing member's proceeds of disposition of his interest in the partnership. Where the proceeds of disposition are greater than the amount of money and the cost amount of partnership property received by the member from the partnership, the member may add the excess to the cost amount of certain property received from the partnership on its dissolution.

Subparagraph 98(5)(a)(i) provides that the continuing member's proceeds of disposition are equal to the aggregate of the adjusted cost base of his interest in the partnership and the cost to him of acquiring all other interests in the partnership. New subparagraph 98(5)(a)(i), which applies to partnerships that cease to exist after January 15, 1987, provides that in determining this aggregate the member must use the adjusted cost base of his interest and of each other interest so acquired by him. Therefore, where a partnership has ceased to exist by reason of the winding-up of a subsidiary corporation into its parent corporation, the adjusted cost base, as determined under subsection 88(1) of the Act, in respect of the subsidiary's partnership interest is to be used in determining the parent's proceeds of disposition under subparagraph 98(5)(a)(i).

Clause 74

Residual Partnership Interest

ITA
98.1

Section 98.1 of the Act provides rules applicable to a taxpayer who ceases to be a member of a partnership but who continues to have a residual interest in the partnership.

Paragraph 98.1(1)(c) applies in respect of residual partnership interests where the total amount deducted under subsection 53(2) in computing a taxpayer's adjusted cost base of a residual partnership interest exceeds the cost to the taxpayer of that interest and the total amount added to that cost under subsection 53(1). The amount of such excess is treated as a gain of the taxpayer for the year from a disposition at that time of the residual interest.

Paragraph 98.1(1)(c) is amended to clarify that such gains are to be treated as gains of the taxpayer for his taxation year that includes the end of the partnership's fiscal period. In order to ensure that such gains are eligible for the capital gains exemption, paragraph 98.1(1)(c) is also amended, applicable to the 1985 and subsequent taxation years, to treat the taxpayer as having disposed of that interest in the year for the purposes of determining his entitlement to claim a capital gains exemption under section 110.6 of the Act.

Clause 75

Beneficiary's Taxable Capital Gain

Subclause 75(1)

ITA
104(21.2)

Subsection 104(21.2) of the Act provides rules for determining the extent to which a beneficiary of a trust is entitled to claim a capital gains exemption under section 110.6 in respect of net taxable capital gains of the trust allocated to the beneficiary by reason of a designation made under subsection 104(21). Paragraph 104(21.2)(b) provides that, for the purposes of section 110.6, the beneficiary's taxable capital gain is the proportion of the trust's eligible taxable capital gains (as defined in subsection 108(1)) that the designated amount is of the trust's net taxable capital gains for the year. The beneficiary's net taxable capital gain is determined separately for gains realized on the disposition of qualified farm property, qualified small business corporation shares and other capital properties.

Where, as a result of incurring investment expenses, a trust has a cumulative net investment loss (as defined in subsection 110.6(1)) at the end of its taxation year, the eligible taxable capital gains of the trust for that year may be less than the trust's net taxable capital gains for the year. Since the amount in respect of which a beneficiary may claim the capital gains exemption in respect of designated gains is limited to a proportion of the trust's eligible taxable capital gains, the beneficiary's exemption under section 110.6 may be inappropriately limited in certain circumstances. In effect, the cumulative net investment loss may be accounted for twice.

For example, assume that a trust with only one beneficiary realizes in a taxation year a $100 taxable capital gain on the disposition of a capital property that is neither a qualified farm property nor a qualified small business corporation share. The trust incurs a $20 investment expense in that year and has no other income or losses in the year. Its cumulative net investment loss at the end of the previous year was nil and it has not realized capital gains in the past. The trust designates under subsection 104(21) $80 as being the taxable capital gain of the beneficiary. Applying the formulae of paragraph 104(21.2)(b), where

A = $80,
B = $80,
C = $100,
D = NIL,
E = NIL,
F = $100, and
G = $100,

results in only $64 being designated to the beneficiary for the purposes of the capital gains exemption.

The description of "C" in paragraph 104(21.2)(b) is therefore amended, applicable to the 1988 and subsequent taxation years, so that "C" will be the net taxable gains of the trust for the designation year minus the excess of the trust's investment expense over its investment income for that year. The amount used for "C", however, may not be less than the aggregate of all amounts used for "B" in the formulae. In the foregoing example, the amount to be used for "C" would be $80, instead of $100, resulting in designated taxable gains of the beneficiary, for the purpose of the exemption, of $80, as opposed to $64. This is the result that would have been achieved had the beneficiary realized the gains and incurred the investment expense directly.

Subclause 75(2)

ITA
104(27)

Subsection 104(27) of the Act allows a testamentary trust that is resident in Canada to flow through to a beneficiary the character of certain pension benefits received by the trust and included in the beneficiary's income. The purpose of this flow-through of income is, in part, to allow a beneficiary to make a contribution under paragraph 60(j) to a registered pension plan (RPP) or a registered retirement savings plan (RRSP) where the beneficiary would have been entitled to make such a contribution if the income had been received directly by the beneficiary.

Subsection 104(27) of the Act is amended so that it applies in a similar manner to a benefit received out of or under a foreign retirement arrangement, as newly defined in subsection 248(1). As a consequence, an amount out of a foreign retirement arrangement that would have been an eligible amount under new section 60.01, if it had been received by a beneficiary, may be flowed-out to the beneficiary for the purposes of determining a deduction for an RPP or RRSP contribution under paragraph 60(j).

This amendment is applicable to the 1990 and subsequent taxation years.

Clause 76

Capital Interest in Trusts

ITA
107

Section 107 of the Act provides certain rules relating to the acquisition and disposition of interests in, and the property of, trusts.

Subclause 76(1)

ITA
107(1)

Subsection 107(1) of the Act contains special rules applicable on the disposition of a capital interest in a trust. Paragraph 107(1)(a) ensures that a disposition of an interest in a personal trust will not give rise to a capital gain unless the proceeds of disposition exceed both the adjusted cost base and the cost amount of the interest (for this purpose, the "cost amount" of a capital interest in a trust is determined under paragraph 108(1)(d) with reference to the cost amount of trust property).

Paragraph 107(1)(a) is amended so that it also applies to prescribed trusts. The purpose of this amendment is to provide consistent treatment for prescribed trusts under paragraph 107(1)(a) and subsection 107(2).

It is intended that trusts prescribed for the purpose of paragraph 107(1)(a) will be the same as those prescribed for the purposes of subsection 107(2). As provided under section 4800.1 of the Regulations, a trust maintained principally to secure a debt owing to a beneficiary, a voting trust and a trust to hold an employer's shares for the benefits of the employer's employees are each prescribed trusts for this purpose.

This amendment generally applies to dispositions after 1987.

Subclause 76(2)

ITA
107(2)

Subsection 107(2) of the Act provides a roll-over on the distribution of property from a personal or prescribed trust to a beneficiary in satisfaction of all or part of the beneficiary's capital interest in such a trust. Thus, where trust property is distributed to a beneficiary in these circumstances, the trust is generally not taxable on the distribution. In addition, the beneficiary is generally deemed to have acquired the property at its cost amount (as defined in subsection 248(1)). The cost at which the beneficiary acquires the property is generally increased to the extent of any excess of the adjusted cost base of the beneficiary's former capital interest in the trust over the cost amount (as defined in paragraph 108(1)(d)) to the beneficiary of such interest. The beneficiary is deemed to have received proceeds of disposition for the trust interest equal to that cost.

Paragraph 107(2)(e) is introduced to permit eligible capital property of a personal or prescribed trust to be transferred from the trust to a beneficiary under subsection 107(2) for proceeds of disposition equal to 4/3 of its cost amount. Paragraph 107(2)(e) also provides, in conjunction with subsection 107(3), that the same grossed-up amount, plus one-half of any increase referred to in the previous paragraph, would be considered the cost of the property to the beneficiary. In addition, the beneficiary's interest in the trust would be considered to have been disposed of for that grossed-up amount plus the entire amount of any such increase.

This amendment is appropriate because only 3/4 of the proceeds with respect to the distribution of an eligible capital property by a trust are deducted in computing the cumulative eligible capital of the trust under paragraph 14(5)(a). Similarly, only 3/4 of the beneficiary's cost of the eligible capital property is included in computing the beneficiary's cumulative eligible capital. In order not to allow a trust to claim an inappropriate deduction under paragraph 20(1)(b) or section 24 after the transfer of eligible capital property to a beneficiary, the proceeds from the disposition of such property for a trust are grossed-up by 4/3 so that the trust would have a nil balance of cumulative eligible capital in the event that it transfers all of its eligible capital property to beneficiaries.

Paragraph 107(2)(e) also provides that an eligible capital property transferred under the provision maintains its tax characteristics after its transfer to a beneficiary. Thus, where the eligible capital expenditure of the trust in respect of such property exceeds the cost at which the trust's beneficiary is deemed to acquire the property, 3/4 of such excess is deemed to have been allowed as a deduction to such beneficiary under paragraph 20(1)(b). The purpose of this measure is to ensure that a beneficiary will not be entitled to claim a deduction under section 110.6 on a subsequent disposition of such property in respect of amounts that would have been recaptured and included in the income of a trust under section 14 had the trust continued to hold the property until its disposition to a third party.

These amendments are applicable with respect to distributions made after July 13, 1990.

Subclause 76(3)

ITA
107(2.01)

Spousal trusts are permitted to take advantage of the principal residence exemption by virtue of subsection 40(5) of the Act. New subsection 107(2.01) of the Act is introduced to allow a spousal trust to take advantage of the capital gains exemption for principal residences on the rollover of such property to a beneficiary of the trust.

The new rule is intended to correct an anomaly arising from the application of subsection 40(7) to beneficiaries of pre-1972 spousal trusts after the death of the spouse who has a life interest under the trust. Under subsection 40(7), property distributed to a trust beneficiary is considered to have been acquired by the trust beneficiary at the time it was last acquired by the trust. As a consequence, the trust beneficiary's principal residence exemption will generally be reduced under paragraph 40(2)(b) unless the trust beneficiary (or the spouse or minor child of the trust beneficiary) ordinarily inhabited the property (or the housing unit to which the property relates) during the period after the trust last acquired the property. This result is anomalous because the principal residence exemption could have been claimed by the pre-1972 spousal trust if it had actually been sold by the trust rather than distributed to a trust beneficiary on a rollover basis.

New subsection 107(2.01) will apply on a distribution to a beneficiary under subsection 107(2) of property by a spousal trust which so elects in its tax return for the year of the distribution, except where the distribution is made by a post-1971 spousal trust under subsection 107(4). Where the property would, if it had been designated by the trust under paragraph 54(g), be a principal residence, paragraph 107(2.01)(a) provides that the trust shall be treated as having disposed of the property at its fair market value immediately before the particular time that is immediately before the time of the distribution. Paragraph 107(2.01)(b) provides that the trust shall be treated as having reacquired the property at such particular time at that fair market value and, as a consequence, the cost amount to the trust of the property for the purposes of the distribution of the property to the beneficiary under subsection 107(2) will be equal to the same amount. Accordingly, pursuant to subsection 40(7), the principal residence exemption in paragraph 40(2)(b) will apply to the trust beneficiary, on a subsequent disposition of the principal residence, without regard to the period during which the property was held by the trust.

Subsection 107(2.01) is applicable in respect of distributions occurring after May 9, 1985. A special transitional rule will allow a trust to elect to have subsection 107(2.01) apply to distributions occurring after May 9, 1985 and on or before Royal Assent where written notice is given to the Minister of National Revenue before April 1, 1992.

Clause 77

Definitions re: Trusts

ITA
108

Section 108 of the Act sets out certain definitions and rules that apply for the purposes of subdivision k of the Act which deals with the taxation of trusts and their beneficiaries.

Subclause 77(1)

ITA
108(1)(d)

Paragraph 108(1)(d) of the Act defines the "cost amount" to a taxpayer of a capital interest in a trust. Where the capital interest of a taxpayer in a trust is fully or partially satisfied on the distribution of property by the trust, the cost amount of the taxpayer's interest so satisfied is the sum of any cash so distributed and the cost amounts to the trust of other properties so distributed. In any other case, the cost amount of the taxpayer's interest in a trust is determined by pro-rating the amount obtained by subtracting the trust's debts from the sum of the trust's cash on hand and cost amounts of trust property. The pro-ration factor for this purpose at a particular time with respect to a taxpayer's capital interest in a trust is the fair market value of the interest at the particular time divided by the fair market value of all capital interests in the trust at the particular time.

Paragraph 108(1)(d) is amended so that, for the purposes of determining the "cost amount" of a taxpayer's capital interest in a trust, the "cost amount" to a trust of its eligible capital property is grossed-up by 4/3. This amendment, like the amendment to subsection 107(2) described earlier, recognizes that only 3/4 of eligible capital expenditures are included in computing cumulative eligible capital and are thus relevant in determining the cost amount of eligible capital property pursuant to the definition of "cost amount" in subsection 248(1).

This amendment is applicable after July 13, 1990.

Subclause 77(2)

ITA
108(1)(j)

Paragraph 108(1)(j) of the Act defines "trust" for the purposes of a number of rules that apply to trusts for tax purposes. Excluded from this definition are a number of trusts governed by other provisions in the Act for which these rules would not be appropriate. Paragraph 108(1)(j) is amended for the 1990 and subsequent taxation years to exclude a trust governed by a foreign retirement arrangement, as that expression is defined in subsection 248(1).

Subclause 77(3)

ITA
108(2)(b)(iv)

Subsection 108(2) of the Act sets out the conditions under which a trust qualifies as a "unit trust" for the purposes of the Act. The definition is relevant for a number of purposes, including subsection 132(6) under which mutual fund trusts are required to qualify as "unit trusts". Subsection 108(2) is amended so that a trust's taxable capital gains arising from the application of new subsection 49(2.1) are disregarded for the purposes of meeting the condition that at least 95% of its income be derived from, or from the dispositions of, specified investments. A parallel amendment is also being made to the definition of "investment corporation" in subsection 130(3).

Subsection 108(2) is also amended to ensure that, in determining whether a trust meets the 95% test described above, deductions under subsection 104(6) in respect of amounts paid or payable to its beneficiaries are disregarded. As a result, a trust may qualify as a unit trust under paragraph 108(2)(b) even where all of its income for a year is paid or payable to beneficiaries.

These amendments apply to the 1990 and subsequent taxation years.

Clause 78

Deductions in Computing Taxable Income

ITA
110

Section 110 of the Act provides various deductions that may be claimed in computing a taxpayer's taxable income for a year.

Subclause 78(1)

ITA
110(1)(d)

Paragraph 110(1)(d) of the Act provides a special deduction in computing an employee's taxable income in respect of the benefit realized on the exercise of certain employee stock options. This deduction is equal to 1/4 of the amount (1/3 in 1988 and 1989) of the benefit considered under subsection 7(1) of the Act to have been received by the employee in respect of the share. In this respect the benefit is treated in the same way as capital gains. In order to qualify for the deduction, subparagraph 110(1)(d)(iii) requires that the option price be not less than the fair market value of the share at the time the option was acquired.

Paragraph 110(1)(d) is amended, applicable to the 1988 and subsequent taxation years, as a consequence of amendments to subsection 7(1.4) which treat an employee as not having disposed of an option where it is simply exchanged for a new option on a corporate reorganization or capital restructuring. Where subsection 7(1.4) has applied in respect of a new option acquired on an exchange, the fair market value test under paragraph 110(1)(d)(iii) will be considered to have been met in respect of the new option where the exercise price under the original option was no less than the value of the old shares when the original option was granted. Under this amendment, any increase in the fair market value of a share between the time at which an option is first granted and the time of the corporate reorganization or capital restructuring will not preclude a deduction under paragraph 110(1)(d).

Subclause 78(2)

ITA
110(1)(f)

Subparagraph 110(1)(f)(iii) of the Act currently provides a deduction in computing taxable income in respect of social assistance payments to the extent that the payments are received by the individual in respect of whom the social assistance was provided or by a person who resided with the individual at the time the payment was made. This amendment clarifies that the deduction will be allowed to an individual in respect of such payments where they are included in the individual's income by reason of paragraph 56(1)(u), that is, where they do not constitute income from a business or property and are not exempt income under new paragraph 81(1)(h). This amendment applies to the 1991 and subsequent taxation years.

Subclause 78(3)

ITA
110(1)(i)

Part VII of the Unemployment Insurance Act requires an individual who has received unemployment insurance benefits in a year and who has income for the year in excess of a stated limit to repay a portion of the benefits received. The amount repaid may be deducted in computing the individual's taxable income. The repeal of paragraph 110(1)(i) of the Act, together with the addition of new paragraph 60(v.1) of the Act, provide that the amount repaid is deductible in computing income rather than taxable income. As a result of this change, the deduction will be taken into account in determining the individual's income for the purposes of the provisions requiring higher-income individuals to repay all or part of old age security pensions and federal family allowance payments. The repeal of paragraph 110(1)(i) and the addition of paragraph 60(v.1) are applicable to the 1989 and subsequent taxation years.

Subclause 78(4)

ITA
110(1.5)

New subsection 110(1.5), which applies to the 1988 and subsequent taxation years, ensures that certain changes in share structures that occur after a stock option is granted are taken into account in applying the deduction in respect of such options under subparagraph 110(1)(d)(iii) of the Act. For example, where subsequent to the granting of a stock option, the shares subject to the option are split two for one the relevant amount for the purposes of subparagraph 110(1)(d)(iii) will be one-half of the value of the share at the time the option was granted.

Clause 79

Charitable Donations

ITA
110.1(1)

Subsection 110.1(1) of the Act provides a deduction in computing taxable income in respect of corporate charitable donations, gifts to Her Majesty and gifts of certified cultural property to designated institutions and public authorities. The amendments to this provision, which apply after December 11, 1988, are strictly technical. Subsection 110.1(1) is amended to adopt wording which is consistent with that used in new subsection 118.1(10) and the charitable donation tax credit for individuals. Paragraph 110.1(1)(c), which refers to sections of the Cultural Property Export and Import Act, is also amended as a consequence of the re-numbering of that Act.

Clause 80

Forward Averaging

ITA
110.4(8)(b)(ii)

Section 110.4 of the Act provides the rules for including "forward-averaged" amounts in the taxable income of an individual. Such amounts are drawn from the individual's accumulated averaging amount, the amount of which is determined under subsection 110.4(8). That subsection provides that the accumulated averaging amount of a deceased individual for the year of death is equal to the individual's accumulated averaging amount at the end of the preceding year minus any forward-averaged amount brought back into taxable income for the year of death. Subparagraph 110.4(8)(b)(ii) currently refers to the amount determined under paragraph 110.4(8)(a) where, in fact, it should refer to the amount determined under subparagraph 110.4(8)(a)(i) for the year of death. This amendment, which applies to the 1988 and subsequent taxation years, corrects this error.

Clause 81

Lifetime Capital Gains Exemption

ITA
110.6

Section 110.6 of the Act sets out the rules for calculating an individual's capital gains exemption in respect of capital gains arising from dispositions of property after 1984.

Subclauses 81(1) to (11)

ITA
110.6(1)

Subsection 110.6(1) of the Act defines a number of terms which apply for the purposes of the lifetime capital gains exemption. The amendments to this subsection alter a number of those definitions.

Subclause 81(1)

"interest in a family farm partnership"

An individual's interest in a family farm partnership constitutes qualified farm property of that individual and, as such, capital gains realized on the disposition of that interest will be eligible for the $500,000 capital gains deduction provided under subsection 110.6(2). The definition "interest in a family farm partnership" requires that all or substantially all of the property of the partnership at the time of disposition must have been used, by the partnership or certain persons, in the course of carrying on the business of farming in Canada throughout a period of at least 24 months before that time.

A number of changes have been made to this definition, applicable to the 1988 and subsequent taxation years. The requirement that at the time of a disposition of an interest in the partnership substantially all of its property at that time had been used in a farming business throughout a 24 month period is not appropriate. It is particularly inappropriate in the case of inventory. The definition is modified to require that, throughout any period of at least 24 months before the relevant time, more than 50 percent of the fair market value of the partnership property was attributable to property used principally in the course of carrying on a farming business in Canada. Thus, in applying this definition, the relevant test will be based on the use made of the various assets held by the partnership during the 24 month period, rather than on the length of time that the specific assets of the partnership held at the time of disposition had been used. Basing the test on the fair market value of the property will also provide greater certainty and is consistent with recent amendments made to the definitions "small business corporations" and "qualified small business corporation share".

In order to ensure that an interest in a family farm partnership does not qualify as such long after the partnership's farming assets may have been disposed of in favour of non-farming assets, new paragraph (b) of the definition imposes the requirement that, at the relevant time, all or substantially all of the fair market value of the partnership property was attributable to property that has been used principally in the course of carrying on a farming business in Canada by the partnership, the partner or other persons referred to in paragraph (a).

Subclauses 81(2) to (4)

"investment expense"

The definition "investment expense" in subsection 110.6(1) of the Act applies for the purposes of determining an individual's cumulative net investment loss which, in turn, is relevant in determining the individual's entitlement to the capital gains exemption. An individual's cumulative net investment loss is calculated as the total of the individual's investment expenses for each year after 1987 over the total of the individual's investment income for those years.

Paragraph (a) of this definition requires an individual to include as an investment expense all amounts deducted in computing the individual's income for the year from property except to the extent that such amounts were otherwise included in computing the individual's investment expense under any other provision of that definition. This paragraph is intended to ensure that only those deductions from property that are not otherwise accounted for in computing the individual's cumulative net investment loss are included under that paragraph. Paragraph (a) is amended to exclude from its application not only those expenses that are otherwise included in computing an individual's investment expense, but also those expenses that have been deducted in computing the individual's investment income for the year. For example, where an individual earns $1000 of rental income in a year but also incurs and deducts $200 in respect of expenses associated with that income, the individual's investment income for the year will be $800. New paragraph (a) ensures that the $200 of expenses is not also added to the individual's investment expense when they have already been applied to reduce his investment income for the year.

Paragraph (a) of this definition has also been amended to exclude from an individual's investment expense interest and other expenses deducted under paragraphs 20(1)(c), (d), (e), (e.1) or (k) in respect of indebtedness incurred for a purpose set out in subsection 18(11), irrespective of when the indebtedness was incurred. This exclusion will apply to such deductions claimed in respect of indebtedness incurred, generally prior to November 13, 1981, for the purposes of making a payment or paying a premium under or to acquire an income-averaging annuity contract, a registered retirement savings plan or a registered pension plan.

Also excluded from the definition is any amount deducted by an individual under paragraph 20(1)(j) as a repayment of a shareholder loan the amount of which had previously been included in the individual's income under subsection 15(2). A similar amendment to the definition "investment income" ensures that both the income inclusion under subsection 15(2) in respect of the loan and the deduction under paragraph 20(1)(j) in respect of the repayment are to be ignored for the purposes of the cumulative net investment loss rules. Where an individual so elects, however, amounts included in the individual's income in the 1988 or 1989 taxation year by reason of subsection 15(2) will be taken into account in determining the individual's investment income. Where the election is made, amounts deducted by the individual under paragraph 20(1)(j) will also be taken into account in determining the individual's investment expense, to the extent of the 1988 and 1989 investment income inclusion relating to subsection 15(2) amounts.

The amendments to paragraph (a) apply to the 1988 and subsequent taxation years, subject to a special transitional rule in respect of certified productions.

Paragraph (b) of this definition includes in a individual's investment expense for a taxation year certain amounts deducted in computing his income for the year from a partnership of which he was a specified member (as defined in subsection 248(1) of the Act). This paragraph is amended, effective for the 1988 and subsequent taxation years, to clarify that certain expenses relating to financing costs incurred by a partnership that has subsequently ceased to exist are also to be included in a specified member's investment expense when deducted by that member pursuant to subparagraph 20(1)(e)(vi) of the Act.

Paragraph (c) of this definition includes in an individual's investment expense amounts deducted in computing his income for a taxation year in respect of the individual's share of any losses, including allowable capital losses, of a partnership of which he was a specified member. Since allowable capital losses are otherwise accounted for in computing an individual's annual and cumulative gains limits, paragraph (c) is being amended, applicable to the 1988 and subsequent taxation years, to exclude an individual's share of partnership capital losses from his investment expense.

Paragraph (e) of this definition includes in an individual's investment expense the individual's loss for the year in respect of certain property owned by him or by a partnership of which he was a member. This amendment clarifies that the individual's share of losses from a partnership of which he was a specified member in the fiscal period of the partnership ending in the year is not to be added to his investment expense under paragraph (e), since such losses are included in paragraph (c) in computing the individual's investment expense for the year. Subject to a special transitional rule for certified productions, the amendment to paragraph (e) applies to the 1988 and subsequent taxation years.

Subclause 81(5)

"investment income"

The definition "investment income" in subsection 110.6(1) of the Act applies, in conjunction with the definition "investment expense", to determine an individual's cumulative net investment loss which, in turn, is relevant in determining the individual's entitlement to the capital gains exemption. A number of amendments are being made to this definition, applicable to the 1988 and subsequent taxation years.

Paragraph (a) of this definition requires an individual to include in his investment income all amounts included in computing the individual's income for the year from property except to the extent that such amounts were included in computing the individual's investment income under any other provision of that definition. Paragraph (a) is intended to ensure that only amounts not otherwise accounted for in computing an individual's cumulative net investment loss are to be included under that paragraph. The exception in this paragraph for amounts otherwise included in computing an individual's investment income will not apply where that income has been applied to reduce the amount of an individual's investment expense. As a result, paragraph (a) is being amended to exclude from its application all income amounts that were otherwise included in his investment income, or deducted in computing his investment expense, for the year.

Paragraph (a) is also amended to exclude from an individual's investment income for a taxation year any amount included in the individual's income for the year in respect of shareholder loans by reason of subsection 15(2) of the Act. Both the income inclusion under subsection 15(2) and the subsequent deduction available under paragraph 20(1)(j) on repayment of the loan will be ignored for the purpose of computing an individual's cumulative net investment loss. Where an individual so elects, however, amounts included in the individual's income in the 1988 or 1989 taxation year by reason of subsection 15(2) will be taken into account in determining the individual's investment income. Where the election is made, amounts deducted by the individual under paragraph 20(1)(j) will also be taken into account in determining the individual's investment expense, to the extent of the 1988 and 1989 investment income inclusion relating to subsection 15(2) amounts.

Paragraph (a) is further amended to exclude from investment income amounts included in the individual's income by reason of paragraph 56(1)(d) or (d.1). The treatment of these amounts for the purpose of determining investment income is set out in more detail in new paragraph (e) of the definition.

Paragraph (b) of this definition includes in investment income an individual's share of the income, including taxable capital gains, of any partnerships of which he was a specified member in the year. Since taxable capital gains are otherwise accounted for in computing an individual's annual and cumulative gains limits, paragraph (b) is being amended to exclude an individual's share of partnership capital gains from his investment income.

Paragraph (d) of this definition requires an individual to include in his investment income the individual's income for the year from certain property owned by the individual or by a partnership of which he was a member. The amendment to this paragraph excludes the individual's share of income from a partnership of which the individual was a specified number (as defined in subsection 248(1) of the Act), since this income is included under paragraph (b) in computing the individual's investment income for the year.

New paragraph (e) of this definition ensures that amounts received in a year by an individual in respect of an annuity (other than an income-averaging annuity contract or an annuity purchased pursuant to a deferred profit sharing plan) and included in the individual's income under paragraph 56(1)(d) or 56(1)(d.1) of the Act will be included in the individual's investment income for the year. In the case of an annuity payment required to be included under paragraph 56(1)(d), the capital portion of that payment that is deducted under paragraph 60(a) of the Act will also be deducted from the amount of the annuity payment in determining the individual's investment income.

Subclauses 81(6) to (8)

"qualified farm property"

Subsection 110.6(2) of the Act provides to individuals a special exemption of up to $500,000 for capital gains realized on the disposition of qualified farm property, as defined. A number of changes have been made to this definition.

First, the definition has been modified to clarify that the property is not required to be used in the course of carrying on the business of farming at the time of its disposition. Provided that the other conditions of the definition have been satisfied, prior use of the property in the circumstances described in subparagraphs (a)(vi) or (vii) will suffice.

Second, the application of the tests set out in subparagraphs (a)(vi) and (vii) has been modified. Subparagraph (a)(vii), which provides a revenue test and a holding period requirement, was added to this definition as a result of tax reform and is generally applicable to property acquired after June 17, 1987.
Subparagraph (a)(vi), which applies to property acquired on or before that date, preserves the use tests that were originally enacted with the introduction of the capital gains exemption in 1985. In certain situations, however, taxpayers who have acquired farm property before June 18, 1987 may find that, although they are able to satisfy the generally stricter requirements of subparagraph (a)(vii), they cannot meet the conditions set out in subparagraph (a)(vi) and are not, therefore, eligible for the special exemption in respect of capital gains realized on the disposition of that property. The application of these provisions is therefore modified, applicable to the 1988 and subsequent taxation years. The tests

currently set out in subparagraph (a)(vii) will become the general rule, applicable to all property whenever acquired. Taxpayers who fail to meet those tests and who last acquired the property before June 18, 1987 will still qualify for the enhanced exemption if they are able to satisfy the tests currently set out in subparagraph (a)(vi). The substance of each of these tests remains unchanged; however, subparagraph (a)(vii), being the general rule, has been renumbered as subparagraph (a)(vi) and subparagraph (a)(vi) has been renumbered as subparagraph (a)(vii).

Finally, paragraph (d) of the definition, which provides that eligible capital property will constitute qualified farm property under certain circumstances, is being amended, applicable to the 1988 and subsequent taxation years. Generally, real property acquired by an individual from, for example, a parent will constitute qualified farm property of the individual if the parent had met the tests set out in the definition, even where the individual does not carry on the business of farming. This result does not arise for eligible capital property, such as a farm quota, however, since paragraphs 70(5.1)(b) and 73(3)(d.1) of the Act provide, under these circumstances, that such property of the parent becomes capital property and not eligible capital property of the individual. In order to more closely parallel the treatment afforded real property under these circumstances, new subparagraph (d)(ii) provides that, for the purposes of the definition "qualified farm property", eligible capital property will be considered to include capital property to which paragraph 70(5.1)(b) or 73(3)(d.1) applied.

Subclauses 81(9) and (10)

"qualified small business corporation share"

Only capital gains on dispositions of "qualified small business corporation shares" of individuals qualify for the special $500,000 capital gains exemption for small businesses. In order to be a qualified small business corporation share, one of the tests applied is whether a share was a share of a corporation that meets an active business asset test throughout a holding period. This active business asset test requires that more than 50% of the fair market value of the assets of the corporation must have been used by it or a related corporation in an active business carried on primarily in Canada or must be shares or debt of connected corporations that meet an active business asset test throughout a required holding period.

Subparagraph (c)(i) of this definition is amended to require that assets must be used principally in an active business in order to qualify as active business assets. Subparagraph (c)(ii) of this definition provides that, where a holding corporation owns shares or debt of connected corporations, the shares or debt will qualify as active business assets of the holding corporation only where they satisfy a holding period requirement and an active business asset test throughout that required holding period. The holding period requirement in subclause (c)(ii)(A) provides that the shares or debt must not have been owned by anyone other than the corporation or a person or partnership related to it throughout the 24 months preceding the determination time. For this purpose, paragraph 110.6(14)(e) treats a person as being related to the holding corporation in respect of shares transferred to the holding corporation where all or substantially all of the consideration which that person receives on the transfer consists of common shares of the holding corporation.

The amendment to subclause (c)(ii)(A) of this definition provides that the holding period requirement will be met where the shares or debt of the connected corporation were not owned by anyone other than the holding corporation, a person or partnership related to the holding corporation or a person or partnership related to such a person or partnership. This amendment ensures that the holding period requirement operates appropriately when shares of an operating corporation are transferred by the original shareholder through more than one level of holding corporations.

Clause (c)(ii)(B) of the definition requires a connected corporation to meet an active business asset test throughout a required holding period. The amendment to this clause is consequential on the change to the required holding period in clause (c)(ii)(A) of the definition.

Where any particular corporation in a chain of corporations does not meet a 90% active business asset test, paragraph (d) of this definition requires that all other corporations connected with particular corporation (within the meaning of subsection 186(4) of the Act) to meet a 90% active business asset test. This special rule is intended to ensure that the 50% fair market value requirement cannot be circumvented through the stacking of several intermediary holding companies below the particular corporation. Inappropriate results may occur under this special rule where corporations are connected by reason of the application of subsection 186(2) of the Act to subsection 186(4) since, under the extended definition of control in subsection 186(2), corporations other than corporations in which the particular corporation owns shares directly or indirectly through other corporations could be treated as being connected.

The amendment to paragraph (d) of the definition "qualified small business corporation share" restricts its application to those corporations connected with the particular corporation in which the particular corporation has a direct or indirect interest. Specifically, new subparagraph (d)(ii) provides that, in order for the special rule in paragraph (d) to apply to a corporation, the particular corporation must own some of its shares. For this purpose, shares owned indirectly by the particular corporation through any number of levels of other corporations are considered to be owned by the particular corporation.

Paragraphs (e) and (f) of this definition are intended to ensure that the holding period and active business asset tests in that definition operate effectively where shares are received in substitution for other shares. Those paragraphs provide that the original share must, throughout the part of the 24-month period preceding the determination time that is before the time of substitution (referred to as "the holding period"), not have been owned by a person or partnership other than a person or partnership described in paragraph (b) or subparagraph (c)(ii) of the definition.

In addition, the original share must be a share of a corporation that meets an active business asset test throughout the holding period.
In order to accommodate shares of newly incorporated companies that are substituted for other shares, the active business asset test in both of those paragraphs is amended to require that the original shares meet the active business asset test only throughout the part of the holding period during which the shares were owned by a person or partnership described in paragraph (b) or subparagraph (c)(ii) of the definition.

All of the amendments to this definition apply with respect to dispositions of shares occurring after June 17, 1987.

Subclause 81(11)

"share of the capital stock of a family farm corporation"

An individual's share of the capital stock of a family farm corporation constitutes qualified farm property of that individual and, as such, capital gains realized on the disposition of that share will be eligible for the special $500,000 capital gains exemption provided under subsection 110.6(2). The definition "share of the capital stock of a family farm corporation" requires that all or substantially all of the property of the corporation at the time the share is being disposed of was either used by the corporation or certain other persons in the course of carrying on a farming business in Canada throughout a period of at least 24 months before that time or consisted of shares of or obligations issued by other corporations that met that requirement (or was a combination of both types of property).

A number of changes are being made to this definition, applicable to the 1988 and subsequent taxation years. First, the scope of paragraph (b) of the definition has been broadened to include property of the corporation that is any indebtedness, whether issued or not, of other corporations that satisfy the conditions of the definition. This change is also consistent with amendments being made to the definitions "small business corporation" and "qualified small business corporation share" and provides flexibility to corporations whose assets include receivables or other indebtedness of, for example, a subsidiary corporation that are not bonds, debentures, bills, notes, mortgages, hypothecs or similar obligations issued by the subsidiary.

Second, the requirement that at the time of the disposition of the share substantially all of the property of the corporation had been used in a farming business throughout the 24 month period is not appropriate. The definition is modified to require that, throughout any period of at least 24 months before the relevant time, more than 50 percent of the fair market value of the corporation's property was attributable to property used principally in the course of carrying on a farming business in Canada (or to shares or indebtedness of other corporations that meet this test). Thus, in applying this definition, the relevant test will be based on the use made of the various assets owned by the corporation during the 24 month period, rather than on the length of time that the specific assets owned by the corporation at the time of disposition had been used. Basing the test on the fair market value of the property will also provide greater certainty and is consistent with recent amendments made to the definitions "small business corporation" and "qualified small business corporation share".

In order to ensure that a share of the capital stock of a family farm corporation does not qualify as such long after the corporation's farming assets have been disposed of in favour of non-farming assets, new paragraph (b) of the definition imposes the requirement that, at the relevant time, all or substantially all of the fair market value of the corporation's property was attributable to property that has been used principally in the course of carrying on a farming business in Canada by the corporation or by a person or partnership referred to in paragraph (a) (or to shares or indebtedness of corporations that satisfy those criteria).

Subclauses 81(12) and (13)

ITA
110.6(14)

Subsection 110.6(14) of the Act provides certain rules that apply for the purposes of the definition "qualified small business corporation share" in subsection 110.6(1). Paragraph 110.6(14)(c) treats a beneficiary of a personal trust as being related to the trust while he or she is a beneficiary. This will enable the beneficiary to claim the enhanced capital gains exemption in respect of gains realized on the disposition of small business corporation shares acquired from the trust, notwithstanding that the beneficiary has not met the holding period requirements set out in the definition "qualified small business corporation share".

Paragraph 110.6(14)(c) is amended, applicable to the 1988 and subsequent taxation years, to provide that a personal trust will also be treated as being related, in respect of shares of the capital stock of a corporation, to any person from whom it acquired those shares where, at the time the trust disposes of the shares, all beneficiaries (other than registered charities) of the trust are related to the person from whom the trust acquired the shares (or would be related to that person if he or she were living at that time). This amendment, in conjunction with subsection 104(21.2) of the Act, will enable a trust beneficiary to claim the enhanced capital gains exemption in respect of gains realized on the disposition of small business corporation shares by the trust, notwithstanding that the trust has not met the holding period requirements set out in the definition "qualified small business corporation share".

In order for a share to constitute a "qualified small business corporation share", it must be a share of the capital stock of a small business corporation at the time of its disposition. Pursuant to the definition "small business corporation" in subsection 248(1) of the Act, a Canadian-controlled private corporation will be a small business corporation at a given time if all or substantially all (generally 90% or more) of the fair market value of its assets at that time is attributable to assets used in an active business carried on primarily in Canada by the corporation or a related corporation or to indebtedness or shares of connected small business corporations or to any combination thereof. Occasionally, a corporation will temporarily lose its small business corporation status due to an accumulation of passive investments or other non-business assets. This occurrence will usually not pose a problem, in terms of the enhanced capital gains exemption, to a prospective vendor of the corporation's shares, as the corporation can often be "purified" prior to the disposition of its shares in order to ensure that it meets the "all or substantially all" test at the time of disposition. Where, however, a disposition is deemed to have occurred as a consequence of the shareholder's death and the corporation fails to meet the "all or substantially all" test immediately before the time of death, the opportunity to utilize the enhanced exemption may be forgone.

New paragraph 110.6(14)(g), which applies to the 1988 and subsequent taxation years, is intended to provide relief in such situations. Where the shares of a deceased shareholder would otherwise be qualified small business corporation shares immediately before the shareholder's death (that is, but for the fact that the corporation was not a small business corporation at that time), those shares will be treated as being qualified small business corporation shares of the shareholder at that time if the corporation was a small business corporation at any time in the 12-month period preceding the shareholder's death. Expressed more simply, a share disposed of on an individual's death will constitute a "qualified small business corporation share" at the time of disposition if it met the terms of that definition at any time within the 12 month period preceding that disposition and failed to meet those terms at that time by reason only of the corporation's loss of status as a small business corporation.

Subclause 81(14)

ITA
110.6(15)

Subsection 110.6(1) of the Act defines "qualified small business corporation share" and "share of the capital stock of a family farm corporation" for the purposes of the enhanced capital gain deduction available on the disposition of such shares. Under these definitions, certain tests relating to the fair market value of assets used in an active business or farming business carried on by the corporation or a related or connected corporation must be met in order to qualify for the enhanced deduction.

Where a corporation holds a life insurance policy under which a shareholder of that corporation (or of any connected corporation or of any corporation connected to a connected corporation) is the life insured, the fair market value of the policy can escalate substantially if, for example, it is known that the shareholder is terminally ill. This increase in the value of the policy could have the effect of the corporation failing to meet the asset tests set out in the definitions described above with the result that the enhanced deduction would not be available on, for example, the deemed disposition of the corporation's shares that would arise immediately before the shareholder's death. New paragraph 110.6(15)(a) of the Act, which applies to dispositions of shares occurring after June 17, 1987, is intended to avoid this result by providing that, for the purposes of the definitions "qualified small business corporation share", "share of the capital stock of a family farm corporation" and "small business corporation", the fair market value of such a policy at any time prior to the shareholder's death will be considered to be its cash surrender value at that time.

Where a corporation is the beneficiary of a life insurance policy under which a shareholder of that corporation (or certain other corporations) is the life insured, proceeds of that policy received or receivable by the corporation as a consequence of the shareholder's death would normally not be considered to be used in an active business carried on by the corporation if they are to be distributed by the corporation in order to fund an acquisition or redemption of shares under the terms of a buy-sell agreement. This use of such proceeds could result in the corporation failing to meet the asset tests set out in the definitions referred to above. To deal with such situations, new paragraph 110.6(15)(b) will, for the purposes of those definitions, treat (until the acquisition, redemption or cancellation of the shares) the fair market value of such proceeds as not exceeding the cash surrender value of the policy immediately prior to the shareholder's death to the extent that they have been used, either directly or indirectly (for example, where the proceeds are paid as a capital dividend to a shareholder who acquires shares) to redeem, acquire or cancel shares of the capital stock of that corporation (or of a connected corporation or a corporation connected to a connected corporation) that were owned by the person whose life was insured under the policy. The redemption, acquisition or cancellation must occur within 24 months after the death of the person whose life was insured under the policy, although the 24-month period may be extended upon written application to the Minister of National Revenue within that period. For dispositions before July 13, 1990, the redemption, acquisition or cancellation (or the application for an extension) must occur before July 13, 1991.

Example

FMV of life insurance proceeds immediately after the death of the insured:	\$1,000,000
FMV of assets attributable to life insurance proceeds 12 months after the death:	\$1,200,000
Cash Surrender Value of policy immediately before the death of the insured:	\$ 100,000
Amount used to redeem, cancel or acquire shares:	\$ 800,000

Application of Paragraph 110.6(15)(b)

FMV of assets attributable to life insurance policy:

$ 100,000	(deemed FMV of proceeds of $800,000 used in buy-out) (paragraph (b))
200,000	(FMV of proceeds not used in buy-out) (subparagraph (ii))
200,000	(profit generated from proceeds)
$ 500,000	

ITA
110.6(16)

The definition "qualified small business corporation share" of an individual requires that the share be owned by the individual or a related person throughout the 24-month period ending immediately before the disposition of the share. For this purpose, paragraph 110.6(14)(c) treats a personal trust as being related to an individual for any period throughout which the individual was a beneficiary of the trust. The expression "personal trust" is defined in subsection 248(1).

New subsection 110.6(16), which applies to dispositions occurring after June 17, 1987, extends this definition of personal trust to include employee stock purchase trusts referred to in subsection 7(2) of the Act for the purpose of subsections 110.6(1) and (14).

Clause 82

Northern Tax Benefits

ITA
110.7

Section 110.7 of the Act provides, in computing an individual's taxable income for a taxation year, a special deduction in respect of certain travel benefits and living costs where the individual resides, throughout a period of at least 6 consecutive months commencing or ending in the year, in a northern or isolated area that is a "prescribed area" under section 7303 of the Income Tax Regulations. The deduction in respect of employee travel benefits is provided in paragraph 110.7(1)(a). This deduction offsets the income inclusion in respect of benefits provided by an employer to an employee or the employee's family with respect to trips made for the purpose of obtaining necessary medical services not available locally or with respect to travelling expenses in connection with not more than two other trips per year. The deduction in respect of living costs is provided in paragraph 110.7(1)(b). The amount of this deduction is currently set at $225 for each month throughout which an individual resided in a prescribed area, and $450 for each month during which the taxpayer maintained and resided in a self-contained domestic establishment in a prescribed area and no other person residing in that establishment claimed a housing deduction for that month. The total deduction relating to living costs in a prescribed area in a year is limited to 20% of the taxpayer's income for the year.

The amendments to section 110.7 of the Act, which are applicable to the 1988 and subsequent taxation years, change the residency requirements for these special deductions. The amendments provide for a phase-out after 1992 of the prescribed area residency requirement and the introduction of a requirement that the taxpayer reside in a prescribed northern or intermediate zone as defined in draft section 7303.1 of Regulations. For residents of the prescribed northern zone, the deductions will be the same as those now provided for residents in a prescribed area. For residents in the prescribed area intermediate zone, the deductions will be one-half the deductions available with respect to the prescribed northern zone. Furthermore, starting in 1991, the $225 monthly deduction will be converted into a $7.50 daily deduction. An additional deduction of $7.50 per day will be allowed to those individuals who could, but for the conversion, be entitled to the $450 monthly living cost deduction. While the amount of the deduction determined by using the new daily rate is essentially equivalent to that currently determined on a monthly basis, the conversion simplifies the calculation of the allowable deduction by eliminating the rounding operations required under the existing rules.

The following example illustrates the application of the new rules. The example is based on the following assumptions:

1. The taxpayer resided throughout a period of 213 days in two eligible areas:
   - 89 days in Whitehorse, Yukon Territory (prescribed northern zone),
   - 124 days in Chibougamau, Québec (prescribed intermediate zone),

2. Throughout the period of residence in Yukon Territory, the taxpayer lived alone in a self-contained domestic establishment. During that period, the taxpayer made three non-medical employer-paid trips to Vancouver. The costs of those trips, which represent the lowest return airfare, amounted to \$1,200, \$1,350 and \$1,450 and were included in the taxpayer's employment income.

3. Throughout the period of residence in the prescribed intermediate zone, the taxpayer lived in a hotel room.

4. The taxpayer's net income for the year is \$20,000.

The deduction available for 1991 under subsection 110.7(1) is equal to \$4,600 and is computed as follows:

First, the taxpayer may claim \$2,800, representing the more expensive two of the three trips.

Secondly, the taxpayer may claim a living cost deduction of \$1,800, which is the lesser of

(a) \$4,000 (20% of the taxpayer's income for the year), and

(b) \$1,800, i.e. the total of
100% of \$15 x 89 = \$1,335 for the prescribed northern zone
and
50% of \$7.50 x 124 = \$465 for the prescribed intermediate zone.

As illustrated below, an identical result would have been obtained for 1990 by using the monthly rates then applicable in computing the living cost deduction under (b).

(i) $\dfrac{89 \text{ days}}{30 \text{ days}}$ = 2.97 rounded to 3 x 100% x \$450 = \$1,350

PLUS

(ii) $\dfrac{211 \text{ days}}{30 \text{ days}}$ = 7.03 rounded to 7
[7 - 3 (under(a))] x 50% x \$225 = 450

\$1,800

ITA
110.7(1)

Subsection 110.7(1) of the Act sets out the residency requirement for the special deduction and determines the amount of the deduction by reference to the applicable travel benefits and housing circumstances. The residency requirement is changed to reflect the introduction of the prescribed zones. The requirement will be met by an individual for a taxation year where the individual resides for at least 6 consecutive months in an area or areas each of which was a prescribed northern zone or prescribed intermediate zone. Under a special transitional rule, the deduction will also be available for all years before 1995 for those taxpayers who are resident outside those zones but in areas that fall within the existing definition of a "prescribed area". To qualify, the 6-consecutive-month residency period may either begin or end in the taxation year. Where a taxpayer moves from one qualifying area to another, the combined periods of residency in those areas will qualify for the six-month test as long as the periods are not interrupted by residence outside of the qualifying areas. The amount of the deduction depends on the area in which the taxpayer resided, as explained in the note below on subsection 110.7(2).

ITA
110.7(2)

New subsection 110.7(2) of the Act defines "specified percentage" for the purposes of the special deduction provided in subsection 110.7(2). The deduction under section 110.7 in respect of travel benefits and living costs is determined by multiplying the maximum allowance by a specified percentage, which varies depending on the area in which the taxpayer resided. Residency in a prescribed northern zone qualifies for the full deduction, while residency in a prescribed intermediate zone qualifies for the deduction at a rate of 50%. Under special transitional rules that apply before 1995, residency in an area that is both a prescribed intermediate zone and a prescribed area will qualify for the rate applicable to the prescribed area where that rate is higher than 50%. The rates applicable to prescribed areas that are not also in the prescribed northern or intermediate zones are being phased out by allowing a deduction at the rate of 100% until 1992, 66 2/3% in 1993 and 33 1/3% in 1994. Such areas will not qualify for the special deduction after 1994. Under the current law, when an area ceases to be a prescribed are in a taxation year, it still qualifies for deductions at the rate of 66 2/3% for the following year and at the rate of 33 1/3% for the next following year. That rule will continue until the prescribed areas are phased out, except that no area that was a prescribed area and is not a prescribed northern or intermediate zone will qualify for a deduction at more than a 33 1/3% rate in 1994.

ITA
110.7(3)

The deduction under paragraph 110.7(1)(a) for employee travel benefits is in respect of benefits provided by an employer for trips made during the taxation year by the employee or members of the employee's household. New subsection 110.7(3) continues the rule in former paragraph 110.7(1)(d), that any number of trips qualify for this deduction where the trips are for necessary medical services not available locally but that, where the trips are for other purposes, only two trips per year per individual in the household qualify. Where an individual has taken more than two non-medical trips in a year, the taxpayer can select any two trips for calculating the deduction.

ITA
110.7(4)

Former subsection 110.7(2) of the Act is renumbered as subsection 110.7(4). This subsection provides that, where an employee who is resident in a prescribed zone benefits from a tax exemption under subsection 6(6) of the Act in respect of board and lodging at a special work site while maintaining a self-contained domestic establishment in a non-qualifying area, the amount of the exemption reduces the amount of the deduction under paragraph 110.7(1)(b) to which the employee is entitled in respect of that area.

ITA
110.7(5)

Subsection 110.7(5) of the Act provides that in computing the amount deductible by a taxpayer in respect of a particular area, the taxpayer is not allowed to include days which are already included in computing the taxpayer's deduction in respect of another particular area.

The amendments to section 110.7 of the Act are generally applicable to the 1988 and subsequent taxation years. However, transitional provisions are included in order to effect the phasing-in of the amendments as described above.

Clause 83

Losses

ITA
111

Section 111 of the Act establishes the extent to which a taxpayer is permitted to deduct amounts in computing taxable income for the year in respect of losses of other taxation years.

Subclause 83(1)

ITA
111(1.1) and (2)

Where a taxpayer claims an amount under paragraph 111(1)(b) in respect of net capital losses, the amount that may be deducted in respect of those losses under that paragraph against taxable capital gains (and, in the case of an individual, against $2,000 of other income to the extent of the individual's pre-1986 capital loss balance) is determined under subsection 111(1.1) of the Act. The amount that may be deducted under paragraph 111(1)(b) in respect of net capital losses will differ from the amount claimed under paragraph 111(1)(b) where the inclusion rate for capital gains and losses for the year in which the loss is realized differs from the inclusion rate for the year in which it is to be deducted. This adjustment of net capital losses under subsection 111(1.1) is intended to apply only where the loss is deducted against taxable capital gains. The amendment to subsection 111(1.1), which applies to the computation of taxable income for the 1985 and subsequent years, ensures that this adjustment to net capital losses claimed to reflect different inclusion rates will not apply where the loss is a pre-May 23, 1985 loss of an individual that has been deducted against $2,000 of other income.

Subsection 111(2) of the Act permits the deduction of an individual's net capital losses claimed under paragraph 111(1)(b) in the year of death and in the immediately preceding taxation year against all sources of income. The amount deductible under paragraph 111(1)(b) is the aggregate of two amounts. The first amount is the amount of net capital losses claimed by the taxpayer in one of those years, as adjusted under new subsection 111(1.1), that is sufficient to shelter taxable capital gains from tax for those two years. The adjustment under subsection 111(1.1) is intended to reflect any difference between the taxpayer's capital gains inclusion rate for the loss year and the year in which the net capital loss is deducted. The second amount is the excess of the total amount of net capital losses claimed for deduction over the amount of such unadjusted losses that were used to offset the net taxable capital gains for the year. This excess is deductible against income from other sources in those two years after being reduced by any previous capital gains exemptions deducted by the individual.

Two amendments are made to subsection 111(2), applicable to the computation of taxable income for the 1985 and subsequent taxation years. The first amendment provides that, for the year of death and the immediately preceding taxation year, previously undeducted net capital losses of all taxation years are deductible under paragraph 111(1)(b). This amendment ensures that net capital losses for the year of death and the immediately preceding taxation year will be deductible against income from other sources in those two years. The second amendment clarifies that the amount deductible under paragraph 111(1.1)(b) for one of those two years is the excess of the amount of net capital losses claimed for that year over the amount of those net capital losses claimed that, after being adjusted, were sufficient to offset the taxable capital gains of that year.

Subclause 83(2)

ITA
111(3)

Subsection 111(3) of the Act sets out limitations on the deductibility in a taxation year of a loss carryover. Generally, the amount of a loss that may be deducted in a particular year is reduced by amounts that have been deducted in respect of that loss in preceding years. In the case of a net capital loss, the loss is reduced by amounts claimed in respect of the loss rather than amounts deducted. The amount that is deducted in respect of the loss under paragraph 111(1)(b) will differ from the amount claimed under that paragraph whenever subsection 111(1.1) adjusts the net capital loss that may be deducted under paragraph 111(1)(b). This adjustment will occur where the inclusion rate for the year in which the loss is to be deducted differs from the inclusion rate for the loss year. The amendment to subsection 111(3) provides that the amount that may be claimed in respect of a net capital loss is reduced by amounts claimed in respect of that loss in prior years. This amendment to subsection 111(3) applies to the computation of taxable income for the 1985 and subsequent taxation years.

Subclause 83(3)

ITA
111(4)(e)

Paragraph 111(4)(e) of the Act provides that, where control of a corporation has been acquired, the corporation may elect to treat itself as having disposed of certain capital properties and, in doing so, recognize income or gains accrued in respect of the properties prior to the time at which its control was acquired. This amendment clarifies that no such election may be made in respect of depreciable property of a prescribed class to which subsection 111(5.1) applies (that is, where the undepreciated capital cost of the class exceeds the fair market value of property within the class and the amount allowed as capital cost allowance under paragraph 20(1)(a) or deductible under subsection 20(16) in respect of property of the class for the taxation year immediately preceding the acquisition of control) and limits the amount that the corporation may designate as its proceeds from the disposition of a property to the lesser of (i) the fair market value of the property immediately before the acquisition of control, and (ii) the greater of the adjusted cost base of the property to the corporation and the amount designated by the corporation in respect of the property. The corporation's new cost of the property will be the amount designated as its proceeds of disposition, except where the property is depreciable property with a capital cost exceeding those proceeds. In that case, the capital cost of the property after the acquisition of the corporation's control will be treated as being the same as the pre-disposition capital cost, and the excess will be considered to have been allowed to the corporation as capital cost allowance.

This amendment applies to acquisitions of control occurring after July 13, 1990, other than such acquisitions in which the persons acquiring control were obliged on that date to acquire control pursuant to written agreements entered into on or before that date.

Subclauses 83(4) and (5)

ITA
111(8)(b.2)

Paragraph 111(8)(b.2) of the Act defines "pre-1986 capital loss balance", which represents an individual's net capital losses realized before May 23, 1985. These losses continue to be deductible at the rate of $2,000 a year against income other than taxable capital gains. The amendments to this paragraph, which apply to the computation of taxable income for the 1985 and subsequent taxation years, ensure that this balance is reduced by net capital losses claimed in a year rather than net capital losses deducted in the year. The amount claimed in a year will differ from the amount deducted in the year whenever subsection 111(1.1) applies to adjust the net capital loss that may be deducted under paragraph 111(1)(b) to reflect a difference between the inclusion rate for the year in which the loss is to be deducted and that for the loss year.

Clause 84

Taxable Dividends Received by Corporations

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 such corporation. Subsection 112(1) permits a corporation to deduct, subject to certain exceptions, taxable dividends received in computing its taxable income.

Subclause 84(1)

ITA
112(2.4)

Subsection 112(2.4) of the Act denies the intercorporate dividend deduction for dividends received on shares in respect of which certain security arrangements have been made. This amendment, which applies after 5:00 p.m. Eastern Standard Time, November 27, 1986, simply corrects a punctuation error in subparagraph 112(2.4)(b)(i).

Subclause 84(2)

ITA
112(4)

Subsection 112(4) of the Act provides a "stop-loss" rule in respect of losses from sales of shares held as inventory. The amount of such a loss is reduced by any dividends received by the taxpayer on the share unless the taxpayer owned the share for at least 365 days and did not own more than 5% of any class of shares of the corporation that issued the share disposed of. This amendment, which applies with respect to the determination of losses arising in the 1985 and subsequent taxation years where the taxpayer so elects before 1992, and in the 1990 and subsequent taxation years otherwise, provides that the stop-loss rule in subsection 112(4) will apply to an individual only if the corporation that issued the share is a taxable Canadian corporation. In addition, new subsection 112(4) will apply with respect to taxable dividends received by a corporate shareholder only to the extent of the amount of the dividends that was deductible in computing the corporation's taxable income or taxable income earned in Canada.

Subclause 84(3)

ITA
112(4.1)

Subsection 112(4.1) of the Act provides that for the purpose of valuing a share held as inventory, dividends received on the share must be added to the fair market value of the share unless the taxpayer has owned the share for at least 365 days and does not own more than 5% of any class of shares of the corporation that issued the share. This amendment, which applies to the 1985 and subsequent taxation years where the taxpayer so elects before 1992, and to the 1990 and subsequent taxation years otherwise, provides that where the holder of the share is an individual the valuation adjustment provided in subsection 112(4.1) will apply only if the corporation that issued the share is a taxable Canadian corporation. In addition, where the holder of a share is a corporation new subsection 112(4.1) will apply with respect to taxable dividends only to the extent of the amount of the dividends that was deductible in computing the corporation's taxable income or taxable income earned in Canada.

Subclause 84(4)

ITA
112(4.2)

Subsection 112(4.2) of the Act provides a "stop-loss" rule in respect of losses from sales of shares held as inventory by a partnership. A partner's share of such a loss is reduced by the amount of dividends received by the partner on the share unless the partnership held the share for at least 365 days and the partnership, the partner and non-arm's length persons did not own more than 5% of any class of shares of the corporation that issued the share disposed of. This amendment, which applies with respect to the determination of losses arising in the 1985 and subsequent taxation years where the taxpayer so elects before 1992, and to the 1990 and subsequent taxation years otherwise, provides that the stop-loss rule in subsection 112(4.2) will apply to partners that are individuals only if the corporation that issued the share is a taxable Canadian corporation. In addition, new subsection 112(4.2) will apply with respect to taxable dividends received by a corporate partner only to the extent of the amount of those dividends that were deductible in computing the partner's income or taxable income earned in Canada.

Clause 85

Part-Year Residents

ITA
114

Section 114 of the Act provides the rules with respect to deductions allowed in computing the taxable income of an individual residing in Canada during only part of a taxation year. This amendment, which applies to the 1988 and subsequent taxation years, clarifies that, in such a case, the individual may not claim, in respect of deductions described in sections 110 to 111, amounts in excess of those available to individuals who are resident in Canada throughout the year.

Clause 86

Taxable Income Earned in Canada

ITA
115

Section 115 of the Act determines the amount of a non-resident person's income which is subject to tax under Part I of the Act. This amount is referred to as the non-resident's "taxable income earned in Canada".

Subclauses 86(1) and (2)

ITA
115(1)

Paragraph 115(1)(d), (e) and (f) provide for particular deductions in computing taxable income earned in Canada. New paragraph 115(1)(d), which applies to the 1988 and subsequent taxation years, corrects the reference therein to paragraph 110(1)(d) of the Act. New paragraph 115(1)(d.1), which applies to the 1983 and subsequent taxation years, provides a deduction in respect of intercorporate taxable dividends to the extent that such dividends were deductible under subsection 112(1) or (2) or 138(6) of the Act and were included in computing the non-resident taxpayer's taxable income earned in Canada.

Subclause 86(3)

ITA
115(3)

Subsection 115(3) of the Act provides that, for the purposes of section 115, taxable Canadian property as described in subparagraphs 115(1)(b)(i) to (ix) includes an option in respect of any such property irrespective of whether or not the property is in existence. Subsection 115(3), which applies after July 13, 1990, is amended to ensure that an interest in respect of any such property is similarly included.

Clause 87

Dispositions by Non-Residents

ITA
116(5.2)

Subsections 116(5.2) and (5.3) of the Act provide procedures for the reporting and payment of taxes by a non-resident with respect to a proposed or actual disposition of a life insurance policy, a Canadian resource property and certain depreciable property of non-residents. Generally, tax is required to be withheld by the purchaser of such property except where a certificate issued by the Minister of National Revenue is provided by the non-resident to the purchaser evidencing that the required tax has been paid.

Subsection 116(5.2) is amended to extend the same procedures to a disposition of timber resource property (or any interest in or option in respect of such property) by a non-resident and to property (other than capital property) that is real property situated in Canada or any interest in or option in respect of such property.

This amendment applies to dispositions occurring after February 20, 1990, other than dispositions pursuant to agreements in writing entered into on or before that date.

Clause 88

Charitable Gifts - Individuals

ITA
118.1

Section 118.1 of the Act provides rules for determining the availability and amount of a tax credit in respect of charitable gifts made by individuals.

Subclause 88(1)

ITA
118.1(1)

Subsection 118.1(1) of the Act describes gifts made by an individual that are eligible for a tax credit. Subsection 118.1(1) is amended, applicable after December 11, 1988, as a consequence of the re-numbering of the Cultural Property Export and Import Act and to provide consistent wording throughout the provisions concerning charitable donations. As well, subsection 118.1(1) is amended to ensure that, where a gift is described in two or more of the categories of total cultural gifts, total Crown gifts or total charitable gifts, it will first be considered a cultural gift, then a Crown gift and, lastly, a charitable gift.

Subclause 88(2)

ITA
118.1(7) and (7.1)

The amendment to subsection 118.1(7) is consequential to the introduction of new subsection 118.1(7.1) and provides that subsection 118(7) will apply only in those cases where new subsection 118.1(7.1) does not apply.

Subsection 118.1(1) includes a definition of "total cultural gifts" for the purpose of calculating an individual's total gifts for a taxation year. "Total cultural gifts" means objects that the Canadian Cultural Property Export Review Board has determined meet the criteria set out in paragraphs 29(3)(b) and (c) of the *Cultural Property Export and Import Act* and that are gifted to an institution or public body designated under subsection 32(2) of that Act.

New subsection 118.1(7.1) provides that, where an individual who makes a gift described in the definition "total cultural gifts", that is a work of art that was created by that individual, and that is property in that individual's inventory, the individual shall be treated as having received proceeds of disposition equal to the cost amount to the individual of the work of art. When read in conjunction with subsections 118.1(1) and (3), this means that the artist will be entitled to a credit based on the value of the donations, as established by the Canadian Cultural Property Export Review Board, but will reflect neither a profit nor a loss on its disposition in computing income from the artist's business for income tax purposes.

The following example illustrates the operation of new subsection 118.1(7.1). Assume that an individual artist has made an election under subsection 10(6) to treat the value of the individual's inventory as nil for the purpose of computing income from an artistic endeavour. The individual makes a gift of a work of art from inventory which falls within the definition of "total cultural gifts" in subsection 118.1(1), and which is determined to have a fair market value of $1,000 by the Canadian Cultural Property Export Review Board. Under new subsection 118.1(7.1), the amount required to be included in the income of the individual in respect of the disposition (i.e., the gift), will be nil. However, the fair market value of the gift, $1,000, will be included in the individual's total cultural gifts for the year for the purpose of determining the amount of the tax credit to which the individual is entitled under subsection 118.1(3).

Subclause 88(3)

ITA
118.1(10)

New subsection 118.1(10) of the Act applies in respect of gifts made after February 20, 1990 and provides for the determination by the Canadian Cultural Property Export Review Board of the value of objects which are certified cultural property for the purposes of the rules relating to the tax treatment of gifts of such property to designated Canadian institutions.

Clause 89

Medical Expenses

ITA
118.2

Section 118.2 of the Act provides rules for determining the amount which may be claimed, as a tax credit, in respect of an individual's medical expenses.

Subclauses 89(1) and (2)

ITA
118.2(b), (b.1) and (c)

Paragraph 118.2(2)(b) of the Act allows amounts paid as remuneration for a full-time attendant upon, or for the full-time care in a nursing home of, an individual who has a severe and prolonged mental or physical impairment to qualify as medical expenses. This amendment, which is applicable with respect to expenses incurred after 1990, is consequential on the amendments made to sections 118.3 and 118.4 with respect to the disability tax credit available to such individuals.

New paragraph 118.2(2)(b.1), which is applicable with respect to expenses incurred after 1990, allows amounts paid as remuneration for part-time attendant care in Canada for an individual who has a severe and prolonged mental or physical impairment to qualify, up to a maximum of $5,000 ($10,000 where the individual died in the year), as medical expenses, provided the amounts are paid to an unrelated attendant over 18 years of age and no other deduction is claimed in respect of those amounts.

Paragraph 118.2(2)(c) of the Act allows amounts paid as remuneration for a full-time attendant upon an infirm individual who is dependent on others for the individual's personal needs to qualify as medical expenses. The wording of subparagraphs (ii) and (iii) thereof has been changed to parallel, where applicable, that of new paragraph 118.2(2)(b.1). This amendment is applicable with respect to expenses incurred after 1990.

Subclause 89(3)

ITA
118.2(2)(h)

As a result of the conversion of the deduction for medical expenses into a tax credit, eligible medical expenses previously described in paragraph 110(1)(c) of the Act are now found in subsection 118.2(2). Former subparagraph 110(1)(c)(viii.2) provided that, where certain other conditions were met, reasonable expenses for a patient (and, where applicable, an accompanying individual) to travel to a place

80 kilometres or more from the locality of the patient's dwelling to obtain medical services could be claimed as medical expenses. Paragraph 118.2(2)(h) of the Act, which was intended to impose the same conditions as former subparagraph 110(1)(c)(viii.2), currently requires, in all cases, a patient to be accompanied by another individual in order to claim an amount under that paragraph. This amendment, which applies to the 1988 and subsequent taxation years, ensures that a patient may be entitled to claim an amount under paragraph 118.2(2)(h) where the patient travels alone.

Subclauses 89(4) to (7)

ITA
118.2(2)(i), (l) and (l.2)

Paragraph 118.2(2)(i) of the Act allows the purchase of certain items to qualify as medical expenses. Cloth diapers and disposable briefs used by incontinent persons are among the qualified items listed in that paragraph. This amendment, which is applicable with respect to expenses incurred after 1990, qualifies all products designed for use by incontinent persons as medical expenses, through the introduction of new paragraph 118.2(2)(i.l) and an appropriate amendment to paragraph 118.2(2)(i). Those products include diapers, disposable briefs, catheters, catheter trays and tubing.

Paragraph 118.2(2)(l) of the Act allows the cost of acquiring a dog to assist a blind or deaf person (as well as the costs for the care and maintenance of the dog) to qualify as a medical expense. This amendment, which is applicable with respect to expenses incurred after 1990, extends the scope of this provision to individuals who have a severe and prolonged impairment that markedly restricts the use of their arms or legs. The provision is also extended to all animals specially trained to assist disabled individuals.

Paragraph 118.2(2)(l.1) of the Act allows an individual to claim certain expenses in respect of a bone marrow or organ transplant as medical expenses. The amendment to the French version of that paragraph ensures that the expenses qualify whether the patient is the individual or the individual's spouse or dependent, as provided in the English version of that paragraph. The amendment is retroactive to the 1988 taxation year, which is the year when paragraph 118.2(2)(l.1) was introduced.

Paragraph 118.2(2)(l.2) of the Act allows reasonable expenses relating to modifications to a dwelling of an individual who lacks normal physical development or is confined to a wheelchair to qualify as medical expenses. This amendment, which is applicable with respect to expenses incurred after 1990, extends this provision to all individuals who have a severe and prolonged mobility impairment.

Subclause 89(8)

ITA
118.2(2)(m)

Subsection 118.2(2) of the Act sets out the medical expenses that may be included in the computation of a person's medical expense credit. Under paragraph 118.2(2)(m) the cost of a device or of equipment may qualify as a medical expense if it is of a kind the Governor in Council has prescribed by regulation. The proposed amendments would increase the scope of the regulations by allowing the Governor in Council to stipulate not only what kind of device or equipment constitutes a medical expense, but also what it must be used or purchased for in order to qualify as a medical expense.

Clause 90

Mental or Physical Impairment

ITA
118.3

Section 118.3 of the Act provides a tax credit for individuals who have a severe and prolonged mental or physical impairment.

Subclause 90(1)

ITA
118.3(1)(a.1) and (a.2)

Subsection 118.3(1) provides the formula for calculating the tax credit and the conditions for entitlement to the credit for those with a mental or physical impairment.

New paragraphs 118.3(1)(a.1) and (a.2) clarify the various conditions that must be met to become eligible for the credit. The formula in subsection 118.3(1) has been changed to effectively increase from $575 to $700 (17% of $4,118) the amount of the credit for 1991. For subsequent years, the credit will be indexed by reference to the annual increase in the Consumer Price Index in excess of 3 per cent.

Subclause 90(2)

ITA
118.3(2)(a)

Subsection 118.3(2) of the Act provides criteria for determining the entitlement of a supporting individual of a disabled person to claim the disabled person's unused disability tax credit. Paragraph 118.3(2)(a) is amended to clarify that this credit will only be available to the supporting individual where the spouse of the disabled person is not already claiming, in respect of the disabled person, the disability tax credit or any other non-refundable tax credits. This amendment applies to the 1988 and subsequent taxation years.

Subclause 90(3)

ITA
118.3(4)

New subsection 118.3(4) gives to the Department of National Health and Welfare the authority to request from the disabled person, the supporting individual who claims (in whole or in part) the credit in respect of the disabled person or the certifying doctor or optometrist additional information to determine the disabled person's entitlement to the credit. This amendment is applicable to the 1991 and subsequent taxation years.

Clause 91

Nature of Impairment

ITA
118.4

Section 118.4 of the Act sets out circumstances in which an individual will be considered to have a severe and prolonged impairment. The amendment to this section, which is applicable to the 1991 and subsequent taxation years, codifies the eligibility criteria by defining what is a basic activity of daily living for the purposes of the disability credit and by specifying the circumstances under which an impairment is considered to markedly restrict an individual's ability to perform such an activity.

Clause 92

Tuition Fees

ITA
118.5

Subsection 118.5(1) of the Act provides a tax credit in respect of tuition fees paid to certain educational institutions in Canada. Paragraph 118.5(1)(a) is amended for the 1988 and subsequent taxation years to ensure that, where tuition fees paid under a federal or provincial job training program for the benefit of an individual who is entitled to a re-imbursement or assistance in respect of the program, those fees will qualify for the credit only where the re-imbursement or assistance is included in the individual's income.

Clause 93

Education Tax Credit

ITA
118.6

Section 118.6 of the Act defines certain terms which apply for purposes of determining eligibility for the education tax credit and provides the formula for calculating the amount of the credit.

Subclauses 93(1) and (2)

ITA
118.6(1)

Subsection 118.6(1) of the Act provides the definitions "designated educational institution" and "qualifying educational program" for the purposes of the education tax credit. This amendment, which is applicable after June, 1990, extends the application of these definitions to all of subdivision a in Division E of Part I and will, as a result, apply for the purposes of the transfer of the tuition fee and education tax credits.

The definition "qualifying educational program" in subsection 118.6(1) of the Act is being amended for the 1991 and subsequent taxation years to require, except in the case of courses provided by educational institutions certified by the Minister of Employment and Immigration, that, in order to be considered a qualifying educational program, a program must be at a post-secondary school level.

Subclause 93(3)

ITA
118.6(2)

Subsection 118.6(2) of the Act is amended to remove the requirement that an individual be in full-time <u>attendance</u> at a designated educational institution to benefit from the education tax credit. The purpose of this amendment, which applies to the 1991 and subsequent taxation years, is to ensure that the credit is also available to full-time post-secondary students enroled in distance education programs or "correspondence courses".

Clause 94

Tuition Fees and
Education Credit Transfer

ITA
118.9(1)

Section 118.9 of the Act governs the transfer of the tuition fee and education credits of an individual to the individual's parent or grandparent. This amendment, which applies to fees relating to periods after June 1990, requires that, for the purposes of the transfer of the tuition fee credit, only tuition fees paid in respect of a qualifying educational program of a designated educational institution will be eligible. The expressions "qualifying educational program" and "designated educational institution" are defined in subsection 118.6(1) of the Act.

While tuition fees relating to periods after June 1990 and in respect of a qualifying program of an educational institution certified by the Minister of Employment and Immigration will no longer be included in the amount of the tuition fee credit that may be transferred to a parent or grandparent, tuition fees paid in respect of a qualifying program of any other designated institution, such as a Canadian or foreign university, will continue to be eligible for such a transfer.

Clause 95

Part-Year Residents

ITA
118.91

Section 118.91 of the Act provides the rules with respect to non-refundable tax credits allowed to individuals residing in Canada during only part of a taxation year. This amendment, which applies to the 1988 and subsequent taxation years, corrects an anomaly by ensuring that an individual who is resident in Canada during part of the year is entitled to at least the same non-refundable credits that are available to an individual in similar circumstances who is non-resident throughout the year. The amendment also clarifies that an individual residing in Canada only part of the year is not entitled to non-refundable credits in excess of those available to individuals residing in Canada throughout the year.

Clause 96

Non-Resident Individuals

ITA
118.94

Section 118.94 of the Act provides the rules with respect to non-refundable tax credits allowed to individuals who did not reside in Canada at any time in a taxation year. Subject to the special rule in section 217, such individuals are allowed to claim certain non-refundable credits only where all or substantially all (90%) of their income for the year is included in computing their taxable income earned in Canada. This amendment ensures that the 90% rule does not apply to the tuition fee and CPP/UI contribution tax credits. The removal of this limitation in respect of these credits is consistent with the treatment of tuition fees and CPP/UI contributions prior to tax reform, where such amounts were allowed as deductions in computing net income and were not subject to the 90% rule that was applicable to certain deductions allowed in computing taxable income. This amendment applies to the 1988 and subsequent taxation years.

Clause 97

Forward Averaging Credit

ITA
120.1(3)

Subsection 120.1(3) of the Act provides for an adjustment to the amount deducted in computing tax payable as a result of a forward averaging election made by an individual whose income, in whole or in part, is not earned in a province. The rate of this adjustment, which is currently set at 47%, is being increased to 49.5% for 1989 and to 52% for the following years as a consequence of a similar increase introduced under Bill C-28 (1989) in the surtax payable by individuals on their income not earned in a province.

Clause 98

CPP/QPP Disability Benefits of Prior Years

ITA
120.3

New section 120.3 of the Act provides the calculation of the tax payable on that portion of an individual's Canada or Quebec Pension Plan disability benefits received in a year that relates to one or more preceding years. This section applies where the individual elects under the rules set out in new subsection 56(8) to exclude that portion from income for the year of receipt. Where the election is taken advantage of, a calculation is required of the total of the additional tax that would have been payable for the previous years to which the disability benefits related had those benefits been included in the income for those years. This amount is added to the individual's tax otherwise payable for the year of receipt. This amendment is applicable to the 1990 and subsequent taxation years.

Clause 99

Overseas Employment Tax Credit

ITA
122.3(1)(b)

Section 122.3 of the Act provides an "overseas employment tax credit" to individuals resident in Canada who are employed for at least six consecutive months in a foreign country by a specified employer in connection with a resource, construction, installation, agricultural or engineering project.
Paragraph 122.3(1)(b) is amended to provide that the overseas employment tax credit will be available where an individual is employed outside of Canada, rather than in a country other than Canada. This amendment, which applies to the 1985 and subsequent taxation years, is intended to clarify that this credit may, where all other conditions have been met, be available, for example, in connection with an individual's employment on a project in international waters.

Clause 100

Specified Partnership Income or Loss

ITA
125(7)(f) and (g)

Section 125 of the Act sets out the rules for the small businesses deduction available to Canadian controlled private corporations. Paragraphs 125(7)(f) and (g) of the Act define, respectively, the "specified partnership income" and "specified partnership loss" of a corporation that is a member of a partnership. These amounts are relevant in determining a corporate partner's entitlement to the small business deduction provided under subsection 125(1) of the Act.

Paragraphs 125(7)(f) and (g) are amended, effective for the 1985 and subsequent taxation years, to clarify that amounts deducted by a corporate partner in a taxation year will be taken into account in determining the corporation's specified partnership income or specified partnership loss for that year if those amounts were deducted in computing the corporation's income from the business carried on in Canada by the corporation as a member of the partnership. Such deductions will serve to reduce the corporation's specified partnership income or increase its specified partnership loss.

EXAMPLE

Corporation A holds a 50% partnership interest in each of Partnerships X, Y and Z. The income of Partnership X from an active business carried on in Canada for its 1990 fiscal period is $200. The income of Partnership Y from an active business carried on in Canada for its 1990 fiscal period is $1,000. The loss of partnership Z from an active business carried on in Canada is $200.
Corporation A deducts, in its taxation year that includes the end of each partnership's 1990 fiscal period, $300 in respect of expenditures made by it for the purposes of earning income from the business carried on by it as a member of Partnership X and deducts $100 in respect of expenditures made for the purposes of earning income from the business carried on by it as a member of partnership Z. Corporation A's net partnership income that, subject to any other limitations that may apply under section 125 of the Act, is eligible for the small business deduction would be determined as follows:

Specified Partnership Income

Partnership X:	125(7)(f)(i)(A)(I)	(50% of $200)	$100	
	less 125(7)(f)(i)(A)(II)		($300)	
			NIL	
	plus 125(7)(f)(ii)		NIL	
				NIL
Partnership Y:	125(7)(f)(i)(A)(I)	(50% of $1,000)	$500	
	less 125(7)(f)(i)(A)(II)		NIL	
	plus 125(7)(f)(ii)		NIL	
				$500
Partnership Z:				NIL
Aggregate:				$500

Specified Partnership Loss

Partnership X:	125(7)(g)(i)		NIL	
	plus 125(7)(g)(ii)	($300 - $100)	$200	
				$200
Partnership Y:				NIL
Partnership Z:	125(7)(g)(i)		$100	
	125(7)(g)(ii)	($100 - NIL)	$100	
				$200
Aggregate:				$400

Income eligible for the small business deduction

	125(1)(a)(ii) (specified partnership income)	$500
less	125(1)(a)(iv) (specified partnership loss)	400
		$100

Clause 101

Manufacturing and Processing
Tax Credit

ITA
125.1(3)

Section 125.1 of the Act provides for a reduction of federal corporate income tax where a corporation engages in manufacturing or processing activities. The reduction for a year is up to 5% of the corporation's "Canadian manufacturing and processing profits" ("M&P profits") for the year. The latter expression is defined in Part LII of the Regulations.

Paragraph 125.1(3)(b) is amended so that the processing of foreign ore is included in the list of activities the income from which is eligible to be included in a corporation's M&P profits. The purpose of this amendment, in conjunction with proposed amendments to Part LII of the Regulations which would phase-in the manufacturing and processing tax credit in respect of foreign ore processing, is to allow income from foreign ore processing to be eligible for the manufacturing and processing tax credit.

A corporation's M&P profits for a taxation year, as defined in section 5200 of the Regulations, is a pro-rated amount of its "adjusted business income" (ABI) for the year. The corporation's ABI for the year is generally its active business income for the year minus, where it engages in the production or processing of resources, its "net resource income" (NRI) for the year. The corporation's ABI for the year is pro-rated to reflect the proportion of its M&P capital and labour costs for the year (as defined in Part LII of the Regulations) to its total capital and labour costs for the year (also so defined). However, pursuant to section 5201 of the Regulations, certain small manufacturers and processors are not required to pro-rate their ABI for a taxation year in determining their M&P profits for the year.

It is proposed that the rule allowing a small manufacturing and processing corporation not to pro-rate its ABI in determining its M&P profits continue not to apply to corporations engaging in the processing of foreign ore. This amendment is strictly consequential to the proposed amendment to section 125.1 of the Act, described above, under which such activities may now qualify for the reduction in tax under that section.

It is also proposed that section 5203 of the Regulations be amended so that, subject to transitional measures, a corporation's income from the processing of foreign ore be excluded from its NRI for the year. The transitional measures would provide that the amount so excluded in respect of a corporation for a taxation year would be equal to a specified percentage of the excess of its foreign ore processing income for the year over its earned depletion base at the end of the year. The specified percentage would be equal to 10% for a corporation with a 1990 taxation year coinciding with the 1990 calendar year and would rise in 10% increments to 100% for taxation years commencing after 1998. (For a corporation with a taxation year straddling two calendar years, the specified percentage for the taxation year would be determined by reference to the number of days in the taxation year that are in each calendar year.)

It is also proposed that sections 5203 and 5204 of the Regulations be amended so that the cost of capital and the cost of labour for a corporation include costs in respect of foreign ore processing. Because of the proposed amendments to section 125.1 of the Act, a corporation's M&P labour and capital (as defined in section 5202 of the Regulations) would also reflect costs in respect of foreign ore processing.

This proposed treatment of foreign ore processing is consequential on the recent phase-out of earned depletion. The amendments to subsection 125.1(3) recognize that income from such processing is similar to income from the other activities to which section 125.1 applies. The amendment does not apply to Canadian ore processing because income from such activity benefits from the resource allowance provided under paragraph 20(1)(v.1).

The amendments to subsection 125.1(3) are applicable to the 1990 and subsequent taxation years.

Clause 102

Part VI Tax Credit
(Transitional Rule)

ITA
125.2

Section 125.2 of the Act provides a deduction, in computing a financial institution's corporate income tax payable for a taxation year under Part I of the Act, in respect of the liability for the special capital tax for the year on such institutions under Part VI of the Act as well as its unused Part VI tax credits in respect of the seven preceding and three following taxation years.

New paragraphs (d) and (e) of the definition "financial institution" in subsection 190(1) of the Act extend the tax under Part VI to life insurance corporations and certain holding corporations. The tax payable under Part VI of the Act by these financial institutions is pro-rated on the basis of the portion of their taxation year which falls after February 20, 1990, and the purpose of this transitional rule affecting section 125.2 is to limit the credit of such institutions' Part VI tax to their Part I tax that, based on the same pro-ration, is attributable to the period after February 20, 1990.

Clause 103

Foreign Tax Credit

ITA
126

Section 126 of the Act provides a deduction, from a taxpayer's tax otherwise payable under Part I of the Act, in respect of foreign income taxes.

Subclause 103(1)

ITA
126(2.1)(a)(i)

Subsection 126(2) of the Act permits a taxpayer to claim a credit for amounts paid by him in respect of foreign business income taxes. Subsection 126(2.1) of the Act sets out rules to be applied in determining the amount of the credit available. Subparagraph 126(2.1)(a)(i) is amended, applicable to taxation years ending after July 13, 1990, to provide that a taxpayer is not entitled to claim a credit in respect of taxes paid on foreign source business income which is exempt from taxation in Canada by virtue of a treaty provision.

Subclauses 103(2) and (3)

ITA
126(7)(a) and (c)

Paragraphs 126(7)(a) and (c) of the Act define the terms "business-income tax" and "non-business-income tax" for the purposes of determining a taxpayer's foreign tax credit under section 126 and the amount of any deduction which may be available under subsection 20(12) of the Act in computing the taxpayer's income for a taxation year. These paragraphs are amended, applicable to taxation years ending after July 13, 1990, to provide that a taxpayer's "business-income tax" and "non-business-income tax" do not include any foreign taxes paid in respect of amounts that are deductible in computing the taxpayer's taxable income under subparagraph 110(1)(f)(i) of the Act.

Subclauses 103(4) and (5)

ITA
126(7)(d)

Paragraph 126(7)(d) of the Act sets out the definition of "tax for the year otherwise payable under this Part" for the purposes of the foreign tax credit calculation. The amendments to this paragraph add a reference to new section 120.3 -- the special tax on disability benefits received in one year that relate to preceding years. These amendments are effective for the 1990 and subsequent taxation years.

Clause 104

Investment Tax Credit

ITA
127

Subsections 127(5) to (17) of the Act provide rules relating to the investment tax credit that is deductible in calculating the tax otherwise payable by a taxpayer under Part I of the Act.

Subclause 104(1)

ITA
127(9)

"investment tax credit"

Subsection 127(9) of the Act defines the investment tax credit of a taxpayer at the end of a taxation year. This definition is amended to ensure that an investment tax credit will be generated only in circumstances where the income from the business to which a particular expenditure or property relates is subject to tax.

This amendment is generally applicable to property acquired and expenditures made after July 13, 1990, except pursuant to a written agreement entered into on or before that date.

Subclauses 104(2) to (4)

ITA
127(9)

"qualified property"

The definition of "qualified property" in subsection 127(9) of the Act, which applies for the purposes of the investment tax credit, includes certain prescribed buildings and prescribed machinery and equipment that are used primarily for the activities described therein. The first amendment to this definition extends the list of activities for which qualified property may be used to include the harvesting of peat. This amendment applies to the 1985 and subsequent taxation years.

The second amendment to this definition is intended to clarify that, where the taxpayer is a corporation carrying on a business in Canada whose principal business is manufacturing property that it sells or leases, the property acquired by the taxpayer for lease, that is "qualified property", is restricted to the property that is manufactured by the taxpayer. This amendment, which applies to property acquired after July 13, 1990, also clarifies that where the principal business of the corporation is selling or servicing property, the property acquired to be leased, that is "qualified property", is restricted to property of the type that the corporation sells or services.

The third amendment to this definition, which applies after February 25, 1986, provides that for the purposes of this definition, "Canada" includes the offshore region prescribed for the purpose of the definition of "specified percentage" in subsection 127(9).

Subclause 104(5)

ITA
127(10.7)

Subsection 127(11.1) of the Act requires that the base upon which an investment tax credit is earned be reduced by any assistance receivable in respect of the related expenditure. Where the assistance is repaid, the investment tax credit is reinstated by reason of paragraph (f) of the definition "investment tax credit" in subsection 127(9) at the specified percentage in respect of the original expenditure. Under subsection 127(10.1) of the Act, however, an additional investment tax credit is available to eligible small business corporations in respect of the first $2 million of expenditures on research and development incurred in a year to effectively "top-up" the investment tax credit rate in respect of such expenditures to 35%. In the case of a repayment of assistance previously received in respect of such an R&D expenditure, however, the "top-up" to the 35% high rate credit is not reinstated under the existing provisions. This deficiency is corrected in new subsection 127(10.7) which adds to the amount otherwise calculated under subsection 127(10.1) for a year where assistance in respect of an amount which would otherwise have qualified for the high-rate ITC is repaid. New subsection 127(10.7) is applicable in respect of amounts repaid after May 23, 1985.

Subclause 104(6)

ITA
127(11)(a)

Section 127 of the Act provides for an investment tax credit in respect of certain expenditures on "qualified property" (as defined in subsection 127(9)). Qualified property includes certain new buildings and equipment acquired after June 23, 1975 to be used primarily for one of activities described in subparagraphs (c)(i) to (xiii) of the definition. One of these activities is "manufacturing or processing" goods for sale or lease.

Strictly as a consequence of the amendments to paragraph 125.1(3)(b) described previously, paragraph 127(11)(a) is amended so that the processing of foreign ore will continue not to be regarded as "manufacturing or processing" for the purposes of the investment tax credit rules. Nevertheless, the cost of property in respect of the processing of such ore will qualify for the investment tax credit in those circumstances where the foreign ore processing is described in subparagraphs (vi) to (vi.2) of the "qualified property" definition. This amendment is applicable to the 1990 and subsequent taxation years.

Subclause 104(7)

ITA
127(11.2)

New subsection 127(11.2) of the Act provides that property will not be considered to have been acquired and expenditures will not be considered to have been made for investment tax credit purposes until such time as the property that is acquired is considered to have become "available for use" (determined without reference to paragraphs 13(27)(c) and 13(28(d), concerning dispositions). The determination of the time at which a property is considered to have become available for use is described in the commentary to new subsections 13(27) to (31) of the Act.

New subsection 127(11.2) of the Act applies with respect to property acquired and expenditures made after 1989.

Clause 105

Labour-Sponsored Funds
Tax Credit

ITA
127.4

Subclause 105(1)

ITA
127.4(1)

Section 127.4 of the Act provides a tax credit for individual taxpayers equal to 20% of the cost of "approved shares" of a prescribed labour-sponsored venture capital corporation. The credit may not exceed $700 and is available only if the individual is the first purchaser of the shares.

The definition of "approved share" in subsection 127.4(1) of the Act is expanded, effective after 1988, to include not only a share of a prescribed labour-sponsored venture capital corporation acquired by an individual but also such a share irrevocably subscribed and paid for by the individual. Therefore an irrevocable subscription by an individual for such a share, if fully paid in a year or within 60 days thereafter, will qualify under subsection 127.4(3) for the 20% labour-sponsored funds federal tax credit for that year.

The definition of "net cost" in subsection 127.4(1) of the Act is amended, consequential to the amendment to the definition "approved share" contemplating shares subscribed for but not yet issued, to refer to consideration paid in respect of a subscription for an approved share.

Subclause 105(2)

ITA
127.4(3)

Subsection 127.4(3) of the Act provides for a federal labour-sponsored funds tax credit to an individual to a maximum of 20% of the net cost of approved shares acquired by the individual, where a province provides a provincial tax credit of at least 20% of the net cost of the shares. A similar 20% federal labour-sponsored funds tax credit is provided under subsection 127.4(3) to a purchaser of shares of a national labour-sponsored venture capital corporation (LSVCC).

Subsection 127.4(3) is amended to clarify that the federal labour-sponsored funds tax credit is applicable in respect of the purchase of shares in a registered LSVCC even if no province provides a matching tax credit in respect of the purchase of those shares or if such a matching tax credit is less than 20%.

This subsection is also amended to provide that amounts paid in respect of an irrevocable subscription for an approved share will be included in the computation of an individual's labour-sponsored funds tax credit even though the share may not have been issued at the time the credit is claimed. In order to claim the federal tax credit in respect of shares of a registered LSVCC, however, the individual must include the information return required to be provided by the issuer of the share with his or her income tax return.

These amendments are applicable after 1988.

Clause 106

Minimum Tax

ITA
127.52

Section 127.52 of the Act defines the "adjusted taxable income" of an individual for a taxation year for the purposes of determining his minimum tax liability under Division E.1 of Part I of the Act. Adjusted taxable income is calculated on the basis of the various assumptions set out in paragraphs 127.52(1)(a) to (j).

Subclause 106(1)

ITA
127.52(1)(a)(ii)(B)

Paragraph 127.52(1)(a) provides that, in computing an individual's adjusted taxable income for minimum tax purposes, no deduction may generally be claimed in respect of contributions to registered pension plans (RPPs), registered retirement savings plans (RRSPs) or deferred profit sharing plans (DPSPs), except to the extent of certain lump sum amounts received by the individual from pension plans and DPSPs. Paragraph 127.52(1)(a) is amended for the 1990 and subsequent taxation years so this exception also applies on the same basis to lump sum amounts received by an individual from a foreign retirement arrangement, as newly defined in subsection 248(1).

Subclause 106(2)

ITA
127.52(1)(h)

Paragraph 127.52(1)(h) of the Act provides that only certain deductions available in computing taxable income are allowed for minimum tax purposes and the amount deductible for minimum tax purposes is equal to the amount claimed for the purposes of computing the individual's basic Part I tax liability. Among those allowable deductions is that provided under paragraph 110(1)(f) which permits a deduction in respect of an amount exempt from tax by reason of a tax convention or agreement with another country.

The amendment to paragraph 127.52(1)(h), effective for the 1986 and subsequent taxation years, is strictly technical. It ensures that the deduction allowed under paragraph 110(1)(f) for minimum tax purposes reflects any increase in adjusted taxable income resulting from the application of the minimum tax to a capital gain in respect of which a deduction under paragraph 110(1)(f) is provided.

Subclause 106(3)

ITA
127.52(1)(i)(i)

Under subsection 111(1) of the Act, losses for a taxation year may be carried over and deducted in computing taxable income of other taxation years. Paragraph 111(1)(e) provides for an indefinite carry-forward of limited partnership losses.

The French and English versions of subparagraph 127.52(1)(i)(i) are slightly different. The French version provides that, for the purposes of computing the adjusted taxable income of an individual for a year, the amounts deductible under subsection 111(1) are limited to those provided in paragraphs 111(1)(a), (c) and (d). The English version of subparagraph 127.52(1)(i)(i) provides that, for the purposes of computing the adjusted taxable income of an individual for a year, only the amounts deductible under paragraphs 111(1)(a), (c) and (d) are restricted. Neither the French nor English versions of subparagraph 127.52(1)(i)(i) make express reference to paragraph 111(1)(e) -- "limited partnership losses".

Subparagraph 127.52(1)(i)(i) is amended to provide that limited partnership losses will be taken into account in computing the adjusted taxable income of an individual for a taxation year.

This amendment is applicable to taxation years commencing after 1985.

Clause 107

Minimum Tax - Spousal Trusts

ITA
127.55

Section 127.55 of the Act, which exempts individuals from the application of the minimum tax in certain limited circumstances, is amended to exempt a spousal trust (one described in paragraph 104(4)(a)) for the trust's taxation year that includes the time of the beneficiary spouse's death. This relieving amendment is retroactive to the 1986 taxation year - the first year of application of the minimum tax. The exemption for such trusts is consistent with existing paragraphs 127.55(c) and (d) which provide that the minimum tax does not apply to an individual in the year of death.

Clause 108

Refundable Dividend Tax on Hand

ITA
129(3.5)

Subsection 129(3.5) of the Act defines the "reduction at December 31, 1987 of refundable dividend tax on hand" of a corporation, for the purposes of determining the amount to which the corporation is entitled as a dividend refund under subsection 129(1). Paragraph 129(3.5)(d) currently provides that this reduction does not apply to any amount added under paragraph 88(1)(e.5) to a corporation's refundable dividend tax on hand ("RDTOH") in respect of the RDTOH of a subsidiary for a taxation year commencing after 1987. This amendment, which applies to the 1988 and subsequent taxation years, provides that such a reduction will also not apply in respect of the RDTOH of a subsidiary for a taxation year commencing before but ending after 1987.

Clause 109

Investment Corporations

ITA
130

Section 130 of the Act sets out special rules relating to the taxation of investment corporations.

Subclause 109(1)

ITA
130(3)(a)(iii)

Subsection 130(3) of the Act sets out the conditions under which a corporation is considered to be an "investment corporation" qualifying for a reduction of income tax under section 130. It is amended to exclude a corporation's taxable capital gains arising from the application of subsection 49(2) for the purposes of meeting the condition that at least 95% of its income be derived from, or from the dispositions of, specified investments. Subsection 49(2) gives rise to a capital gain where an option expires that had previously been granted for consideration by a corporation to allow others to acquire shares of its capital stock. A parallel change is also being made to the definition of "unit trust" in subsection 108(2).

This amendment applies to the 1990 and subsequent taxation years.

Subclause 109(2)

ITA
130(4)

One of the conditions that a corporation must meet in order to be considered an "investment corporation" is set out in subparagraph 130(3)(a)(vi) of the Act, which requires that the corporation may not have more than 10% of its property invested in shares or debt of any one corporation or debtor, other than a Canadian federal, provincial or municipal government.

Inappropriate results may arise where more than 10% of an investment corporation's property consists of shares and debt of a wholly-owned subsidiary corporation, but less than 10% of the property held by the subsidiary, together with other property of the investment corporation, represents their combined investment in any single corporation or debtor. New subsection 130(4) of the Act deals with such situations by permitting an investment corporation to exclude its investments in wholly-owned Canadian subsidiaries, and to include the property of those subsidiaries with its own, in determining whether it satisfies the 10% limitation imposed under subparagraph 130(3)(a)(vi). The application of new subsection 130(4) is elective and applies to taxation years ending after 1986.

Clause 110

Mutual Fund Corporations

ITA
131

Section 131 of the Act sets out special rules relating to the taxation of mutual fund corporations.

Subclauses 110(1) and (2)

ITA
131(8) and (8.1)

Subsection 131(8) of the Act defines the expression "mutual fund corporation" for the purposes of the Act. A mutual fund corporation is, in general terms, a public corporation 95% or more of the shares of which are redeemable and the only undertaking of which is the investment of its funds. A mutual fund corporation is entitled to distribute certain dividends to shareholders which it may elect to have treated as capital gains and to receive a refund representing tax paid on its net taxable capital gains. These rules integrate the taxation of such gains at the corporate and shareholder levels.

Subsection 131(8) is amended so that it is subject to new subsection 131(8.1), under which a corporation generally does not qualify as a mutual fund corporation at any time where it was reasonable to conclude before that time that the corporation was established or maintained primarily for the benefit of non-resident persons. Such a corporation would only qualify as a mutual fund corporation at that time where

- throughout the period commencing on February 21, 1990 (or if later, the date of its incorporation) and ending at that time, all or substantially all of its property consisted of property other than Canadian real estate, options therein and other taxable Canadian property referred to in subparagraphs 115(1)(b)(ii.1) to (ix), or

- the corporation did not issue a share of its capital stock, other than a stock dividend, after February 20, 1990 and before that time to a person that, after reasonable inquiry, it had reason to believe was not resident in Canada, except where the share was issued pursuant to an agreement in writing entered into before February 21, 1990.

The purpose of new subsection 131(8.1), which applies after February 20, 1990, is to discourage the use of MFCs as an intermediary through which non-resident individuals may invest in Canadian real estate and other taxable Canadian property without being effectively subject to Canadian tax either indirectly at the corporate level or directly at the shareholder level. Such tax planning would have most relevance with respect to investments in Canadian real estate since non-resident persons generally do not benefit from any tax treaty relief with respect to gains from such property.

The definition "mutual fund corporation" is also amended, applicable to the 1990 and subsequent taxation years, to provide that a prescribed labour-sponsored venture capital corporation will be considered to be a mutual fund corporation for income tax purposes. The application of section 131 to such corporations is described in the commentary to new subsection 131(11), below.

Subclause 110(3)

ITA
131(11)

While amended subsection 131(8) of the Act treats prescribed labour-sponsored venture capital corporations (LSVCC's) as mutual fund corporations for the purposes of the Act generally, new subsection 131(11) of the Act contains several overriding provisions concerning the application of the Act to prescribed LSVCC's. New subsection 131(11) provides that taxable capital gains, allowable capital losses and net capital losses are excluded by new subsection 131(11) of the Act from the determination of the refundable dividend tax on hand (RDTOH) of a prescribed LSVCC that is a private corporation. Similarly, such a corporation is precluded from declaring a capital dividend under section 83 of the Act. These provisions are described in further detail below.

New paragraph 131(11)(a) of the Act provides that, for purposes of computing the RDTOH of a prescribed LSVCC under subparagraphs 129(3)(a)(i) and (ii), any amount deducted by the corporation in respect of net capital losses pursuant to paragraph 111(1)(b) shall be deemed to be nil. This provision is a corollary to the exclusion of taxable capital gains from the definition of Canadian investment income for the purpose of calculating the RDTOH of a prescribed LSVCC. (Reference may be made to the commentary describing new paragraph 131(11)(b).)

New paragraph 131(11)(b) of the Act provides that for prescribed LSVCC's paragraph 129(4)(a), which sets out the definition of Canadian investment income for the purposes of the calculation of a corporation's RDTOH in subsection 129(3), shall be read without reference to subparagraph 129(4)(a)(i). This effectively excludes taxable capital gains and allowable capital losses from being taken into account in determining the RDTOH of a prescribed LSVCC.

New paragraph 131(11)(c) of the Act permits a prescribed LSVCC to elect that, with respect to the current and all subsequent taxation years, subsection 84(1) of the Act relating to deemed dividends from an increase in a corporation's paid-up capital shall apply notwithstanding the provisions of subsection 131(4) of the Act which would otherwise preclude such an application of subsection 84(1).

New paragraph 131(11)(d) of the Act clarifies that subsection 131(5) shall not apply to a prescribed LSVCC. Subsection 131(5) enables a mutual fund corporation to claim a refund under section 129 of tax paid under Part IV of the Act in respect of its dividend income. A prescribed LSVCC, however, is exempt from Part IV tax by reason of section 186.1.

New paragraph 131(11)(e) provides that the capital dividend account of a prescribed LSVCC shall be deemed to be nil at all times. This rule will prevent such a corporation from paying a capital dividend, and is appropriate since corporate and investor tax payable in respect of the net taxable capital gains of the LSVCC is already integrated through the treatment afforded capital gains dividends.

These amendments are applicable to the 1990 and subsequent taxation years.

Clause 111

Mutual Fund Trusts

ITA
132(6) and (7)

Subsection 132(6) of the Act defines the expression "mutual fund trust" for the purposes of the Act. A mutual fund trust (MFT) is, in general terms, a widely-held unit trust whose only undertaking is the investment of its funds.

An MFT is effectively allowed to flow-through taxable capital gains to unit holders through designations under subsection 104(21) or, alternatively, receive a refund in respect of those taxable capital gains at the trust level on the redemption of trust units. These rules prevent the double taxation of such gains at the trust and again at the beneficiary levels.

Subsection 132(6) is amended so that it is subject to new subsection 132(7), under which a trust generally does not qualify as a mutual fund trust at any time where it was reasonable to conclude before that time that the trust was established or maintained primarily for the benefit of non-resident persons. Such a trust would only qualify as a mutual fund trust at that time where

- throughout the period commencing on February 21, 1990 (or, if later, the date of its creation) and ending at that time, all or substantially all of its property consisted of property other than Canadian real estate, options therein and other taxable Canadian property referred to in subparagraph 115(1)(b)(ii.1) to (ix), or

- the trust did not issue any of its units, other than as a capitalization of an income distribution, after February 20, 1990 and before that time to a person that, after reasonable inquiry, it had reason to believe was not resident in Canada, except where the units were issued pursuant to an agreement in writing entered into before February 21, 1990.

As in the case of the amendment to the definition of mutual fund corporation discussed above, the purpose of this amendment is to discourage the use of MFTs as an intermediary through which non-resident individuals may invest in Canadian real estate and other taxable Canadian property without being effectively subject to Canadian tax either indirectly at the trust level or directly at the unit holder level.

This amendment applies after February 20, 1990.

Clause 112

Cooperative Corporations

ITA
136(1)

Subsection 136(1) of the Act treats cooperative corporations that would otherwise be private corporations not to be private corporations except for certain purposes of the Act. This amendment to subsection 136(1) provides that a cooperative corporation may be treated as a private corporation for the purpose of section 125.1 of the Act, which provides a tax credit for a corporation's Canadian manufacturing and processing profits to the extent that those profits did not qualify for the small business deduction under section 125 of the Act. This amendment also deletes as unnecessary the reference to section 123.1 of the Act, which levied a corporate surtax from July, 1985 to the end of 1986.

This amendment applies after June 1988, except that the reference in subsection 136(1) to section 152 of the Act is applicable only after April 27, 1989.

Clause 113

Credit Unions

ITA
137(5.1) and (5.2)

Section 137 of the Act contains special rules relating to the taxation of credit unions.

Subsection 137(5.1) of the Act allows a central credit union to allocate taxable dividends and taxable capital gains to its member credit unions. Any taxable dividend so allocated reduces, pursuant to paragraph 137(5.2)(a), the amount of the deduction available under section 112 to the central credit union in respect of intercorporate taxable dividends, and any taxable capital gains so allocated are added, pursuant to paragraph 137(5.2)(b), to the income of the central credit union for the year in respect of which the allocation is made. Each amount allocated to a member credit union is, pursuant to paragraph 137(5.2)(c), deductible by that member in computing taxable income for the allocation year. These provisions, in conjunction with subsection 137(4.1), effectively transfer the dividend income and taxable capital gains realized by the central credit union to the member credit unions for income tax purposes.

Two amendments have been made to these provisions, applicable to the 1988 and subsequent taxation years. First, new paragraph 137(5.1)(c) permits member credit unions to flow-through dividends and capital gains which have been allocated to them from a central credit union to their own members that are also credit unions. This change accommodates credit unions whose corporate structure involves more than two tiers of credit unions. Second, paragraph 137(5.1)(b) has been amended to correct a technical deficiency that arose when the inclusion rate for capital gains was changed from one-half to two-thirds. In order to flow-through capital gains from a central credit union to its members for income tax purposes, the amounts allocated under paragraph 137(5.1)(b) must, in effect, represent the amount by which the non-taxable portion of capital gains exceeds the non-allowable portion of capital losses. In conjunction with the payer's income inclusion under paragraph 137(5.2)(b), the member's income deduction under paragraph 137(5.2)(c) and the interest treatment provided under subsection 137(4.1), the amendment to paragraph 137(5.1)(b) achieves the desired flow-through of capital gains.

Clause 114

Insurers

ITA
138

Section 138 of the Act sets out detailed rules relating to the taxation of insurance corporations.

Subclause 114(1)

ITA
138(2)

Subsection 138(2) of the Act provides that in computing the income and loss of an insurer, other than an insurer that is a resident of Canada that does not carry on a life insurance business, the income and loss from carrying on an insurance business is to be limited to the income or loss from carrying on that insurance business in Canada. In the case of an insurer that is a resident of Canada and carries on a life insurance business, subsection 138(2) provides an exception from the general rule that residents of Canada are taxed on their worldwide income. Non-resident persons are not subject to Canadian tax on their foreign income and as a result an exception is not required to restrict the income or loss of a non-resident insurer to its income from carrying on an insurance business in Canada. The amendment to subsection 138(2), which applies to the 1990 and subsequent taxation years, restricts the application of that subsection to residents of Canada that carry on a life insurance business.

Subclause 114(2)

ITA
138(11.3)

Subsection 138(11.3) of the Act provides for a deemed disposition and reacquisition of property at fair market value where an insurer changes the use of the property in the circumstances described therein. This provision applies for all purposes of the Act except for the purposes set out in the preamble to the subsection. Subsection 138(11.3) is amended to remove the reference in the preamble to "amortized cost" which, by reason of the repeal of paragraph 138(3)(c) of the Act, is no longer appropriate. This amendment applies to taxation years commencing after June 17, 1987 and ending after 1987.

Subclause 114(3) and (4)

ITA
138(11.5)(b) and (k)

Subsection 138(11.5) of the Act provides rules which allow a non-resident insurer to transfer, on a tax-deferred basis, the property of an insurance business carried on in Canada to a qualified Canadian corporation.

One of the tests to be satisfied in order to obtain this "rollover" treatment is set out in paragraph 138(11.5)(b), which requires that a transferor transfer all or substantially all of the Canadian insurance property used or held by it in the year in which it ceases to carry on the Canadian insurance business. New paragraph 138(11.5)(b) clarifies that this test applies only in respect of property owned by the transferor at the time it ceases to carry on the business.

Paragraph 138(11.5)(k) provides that, for certain purposes, the transferee corporation will be treated as the same person as and a continuation of the transferor. The amendment to paragraph 138(11.5)(k) provides that this treatment will also apply for the purpose of the special tax on the investment income of life insurers under Part XII.3 of the Act. As a result any "grandfathering" available to the transferor under that Part will be available to the transferee.

New paragraphs 138(11.5)(b) and (k) apply to transfers of insurance businesses occurring after December 15, 1987.

Subclauses 114(5) and (6)

ITA
138(12)(e)

Subsection 138(9) of the Act requires a multinational life insurer to include in computing its income for a year from a Canadian insurance business, among other amounts, the gross investment revenue that is derived from property used or held by the insurer in that insurance business. Paragraph 138(12)(e) of the Act defines "gross investment revenue" to include amounts such as taxable dividends, interest, rents and royalties included in the insurer's gross revenue for the year. Paragraph 138(12)(e) is amended, applicable to the 1990 and subsequent taxation years, to clarify that gross investment revenue includes amounts included in an insurer's gross revenue as substitutes for interest, rents or royalties, as well as interest earned under an annuity contract. That paragraph is also amended to bring into gross investment revenue the income portion of annuities that it holds.

Clause 115

Gains and Losses of Insurers

ITA
142

Subsection 142(1) of the Act provides special rules for the purposes of computing the taxable capital gains and allowable capital losses of an insurer that is not a resident of Canada or is a resident of Canada and carries on a life insurance business. Where such an insurer carries on an insurance business in Canada and in another country it does not include in its income any taxable capital gains and allowable capital losses from dispositions of property used by it in the year in, or held by it in the year in the course of, carrying on an insurance business outside of Canada. In the case of an insurer that is a resident of Canada and carries on a life insurance business, subsection 142(1) provides an exception from the general rule that residents of Canada are taxed on their worldwide income. In the case of non-resident insurers, however, the rule in subsection 142(1) is already provided for in subparagraph 115(1)(b)(ii.1) of the Act. As a result, subsection 142(1) is amended, applicable to the 1990 and subsequent taxation years, to restrict its application to insurers that are resident in Canada and carry on a life insurance business.

Clause 116

Communal Organizations

ITA
143

Section 143 of the Act contains a special rule governing the taxation of certain communal organizations that do not permit members to own property in their own right. Under subsection 143(1), the collective income of such organization for a taxation year is deemed to be income under a trust. Under subsection 143(2), such income may be allocated to adult members of the communal organization (rather than being taxed at the trust level) in the manner specified and included in the income of designated adult members in each family.

Section 143 of the Act is amended to allow a communal organization which makes an election under subsection 143(2) to elect to have its charitable, Crown and cultural gifts made in a year treated as having been made by its adult members for whom an amount is included in income for the year under subsection 143(2). The new election would allow such an adult member to take into account a percentage share (equal to the member's percentage share of trust taxable income under subsection 143(2)) of such gifts in computing the member's tax credit for charitable contributions under subsection 118.1(3).

The amendments to this section are applicable to the 1990 and subsequent taxation years.

Clause 117

RRSPs

ITA
146(2)(c.4)(i)

Subsection 146(2) of the Act sets out conditions that a plan must satisfy before it may be accepted by the Minister of National Revenue as a registered retirement savings plan. Paragraph 146(2)(c.4)(i) is amended to ensure that the English and French versions of the paragraph correspond in meaning.

Clause 118

Registered Education Savings Plans

ITA
146.1

Section 146.1 of the Act contains the provisions that deal with registered education savings plans (RESPs).

Subclauses 118(1) and (2)

ITA
146.1(1)(c.1)

Subsection 146.1(1) of the Act defines a number of terms for the purposes of section 146.1 and, pursuant to this amendment, for the new tax on overpayments of contributions to RESPs imposed in Part X.4 of the Act.
Paragraph 146.1(1)(c.1) adds a definition of the term "post-secondary educational institution". This definition is relevant to new paragraph 146.1(2)(g) of the Act, which requires that payments from a registered education saving plan to a beneficiary may be made only where the beneficiary is a student in full-time attendance at a post-secondary educational institution and is enroled in a qualifying educational program. Subparagraph 146.1(1)(c.1)(i) defines post-secondary educational institutions in Canada, to be identical to the definition provided in paragraph 118.6(1)(a) of the Act. Subparagraph 146.1(1)(c.1)(ii) deals with educational institutions outside Canada and provides that in order to meet the definition of post-secondary educational institution in such cases, a beneficiary must be enroled in a course of not less than 13 weeks duration. This definition is applicable after February 20, 1990.

Subclause 118(3)

ITA
146.1(1)(d.1)

New paragraph 146.1(1)(d.1) adds a definition of the term "qualifying educational program" by importing the definition contained in subsection 118.6(1) of the Act. This definition requires, among other factors, that a program be of not less than 3 consecutive weeks duration and that the program provide that each student taking the program spend at least 10 hours per week on courses or work in the program.

This definition is applicable after February 20, 1990.

Subclauses 118(4) and (5)

ITA
146.1(1)(h)

Paragraph 146.1(1)(h) of the Act defines a trust as any person who irrevocably holds property or money pursuant to an education savings plan for a number of limited purposes. This amendment to the paragraph updates the wording used in the definition (without changing its meaning) by removing the words "or money" which are redundant in this context, because any money held will be included within the definition of property.

Subparagraph 146.1(1)(h)(v) is intended to accommodate transfers of property between registered education savings plans. This amendment to subparagraph 146.1(1)(h)(v) provides that one of the permitted purposes of a trust under section 146.1 is the transfer of property to another registered education savings plan. This requirement will ensure that property held by a registered education savings plan cannot be transferred to an unregistered plan which, for example, may be non-resident or may not meet the other requirements for registration. This amendment is applicable after July 13, 1990.

Subclauses 118(6) to (9)

ITA
146.1(2)

Subsection 146.1(2) of the Act contains a number of conditions that must be met before an education savings plans will be accepted for registration. The amendments to this subsection reflect in some cases a codification of the existing administrative practice of the Department of National Revenue, and in other cases represent new requirements. The amendments to subsection 146.1(2) are applicable to plans entered into after February 20, 1990, except that the amendments contained in paragraphs 146.1(2)(c), (f) and (j) apply to plans entered into after July 13, 1990 and the amendment contained in paragraph 146.1(2)(l) will only apply to plans entered into after March 31, 1991.

The amendment to paragraph 146.1(2)(a) adds a requirement that the property of any trust established under a plan be held by a licensed trustee. Prior to this amendment, this same requirement was imposed by the administrative practices of Revenue Canada.

Paragraph 146.1(2)(b) requires that, before an education savings plan may be registered, there must be at least 150 subscribers who have entered into plans with the promoter which meet all the other requirements of subsection 146.1(2). The amendment to this requirement is consequential upon the addition of new paragraphs 146.1(1)(g) to (l) and clarifies that the plans described in paragraph 146.1(2)(b) are required to meet only those conditions of subsection 146.1(2) which were applicable when the plans were entered into.

The amendments to paragraphs 146.1(2)(c) and (f) simply update the language used in these provisions and make no substantive changes. The amendments to both paragraphs substitute the phrase "governed by the plan" for the phrase "established under the plan" in describing the trusts created by registered education savings plans. These changes bring the language used in these paragraphs into accordance with the language used elsewhere throughout section 146.1. As well, the term "or money" used in paragraph (f) is unnecessary and has been deleted.

New paragraph 146.1(2)(g) provides, as a condition of registration, that educational assistance payments to beneficiaries of registered education savings plans may be made only where the beneficiary is a student in full-time attendance at a post-secondary institution and enroled in a qualifying educational program.

New paragraphs 146.1(2)(h) and (i) limit the existence of a registered education plan for a specific beneficiary. Paragraph (h) allows payments into a plan to be made over a period not exceeding 21 years. The 21-year contribution limit, along with the $1,500 annual contribution ceiling, result in a maximum lifetime contribution limit to a plan of $31,500. In addition, paragraph 146.1(2)(i) limits the maximum period over which income generated in a plan may be sheltered from tax to 26 years.

New paragraph 146.1(2)(j) accommodates plans that may provide for more than one beneficiary to be named at any given time. It recognizes that an individual may wish to open one registered education savings plan to provide funds for the education of any number of his or her own children or grandchildren. In such a situation, it should be noted that, although the limits on contributions that may be made for a beneficiary are, of course, still applicable, there will be some degree of flexibility in determining the allocation of educational assistance payments from the plan among the qualifying children, as no specific allocation of income is required under the provisions.

New paragraph 146.1(2)(k) ensures that a registered education savings plan will not accept payments in respect of a beneficiary which exceed the $1,500 annual limit. Payments in excess of this limit that are made to a number of plans are dealt with under the penalty tax provisions of new Part X.4.

New paragraph 146.1(2)(l) requires that all plans entered into after March, 1991 provide that the promoter notify the named beneficiary under the plan in writing of the existence of the plan and the name and address of the subscriber under the plan. Where the beneficiary is under the age of 19 and resides with his or her parent, such notification is required to be made to such parent. This new condition for registration of an education savings plan is intended to reduce the possibility of excess contributions being made in respect of a beneficiary.

New paragraph 146.1(2)(m) re-enacts the provisions of paragraph 146.1(2)(g) of the existing Act and requires a RESP to comply with any conditions set out in the Income Tax Regulations.

Subclause 118(10)

ITA
146.1(4)

Subsection 146.1(4) of the Act provides that education savings plans in existence on October 15, 1973 are exempted from the requirement that is contained in paragraph 146.1(2)(e) to file a prospectus. The amendment to this subsection provides that the exemption will apply to any plan where the promoter of the plan is not otherwise required to file a prospectus under any existing securities legislation. It is expected that, where a promoter need not otherwise file a prospectus, he or she will be required to provide to the Minister of National Revenue such information as would normally appear in a prospectus, in order for the Minister to evaluate the plan for registration purposes. The exemption for plans in existence before October 16, 1973 has been deleted, as it is no longer required. This amendment is applicable to plans registered after February 20, 1990.

Subclause 118(11)

ITA
146.1(6.1)

New subsection 146.1(6.1) ensures that where transfers of property are made from one registered education savings plan to another, as provided for under subparagraph (1)(h)(v), the event of the transfer will not of itself give rise to tax under new Part X.4 of the Act. The subsection also provides that transfers between plans cannot be used as a means to extend the life of a plan beyond the term provided for in new paragraphs 146.1(2)(h) and (i). This new subsection is applicable after February 20, 1990.

Clause 119

Registered Retirement Income Funds

ITA
146.3(2)

Section 146.3 of the Act sets out the rules relating to registered retirement income funds. Subsection 146.3(2) imposes certain conditions which must be met before the Minister of National Revenue may accept a retirement income fund for registration. One of these conditions, contained in paragraph 146.3(2)(e), is that the carrier of the fund be required to transfer all or part of the property held in connection with the fund where the annuitant requests it to do so. Where the annuitant requests a transfer of all the property from one fund to another before the transferor carrier has made the minimum payment for the year in which the transfer is made, subparagraph 146.3(1)(f)(i) will operate to restrict the amount to be paid to the value of the property held in the fund immediately before the time of the payment and, as a result, the minimum amount to be paid out of the fund for the year will be nil.

Paragraph 146.3(2)(e) is amended, strictly as a consequence of the introduction of paragraph 146.3(2)(e.1), to require that a carrier of a retirement income fund that is directed to transfer property in the fund to another fund withhold a portion of such property in accordance with new paragraph 146.3(2)(e.1).
New paragraph 146.3(2)(e.1), requires a retirement income fund to provide that, where an annuitant directs that the carrier transfer all or part of the property held in connection with the fund, or an amount equal to its value, to another fund, the carrier must retain all the property or sufficient property to pay the minimum amount under the arrangement for the year. For this purpose, the carrier may assume that the fair market value of the property does not decline after the transfer.

The amendments to this section apply to funds entered into after July 13, 1990.

Clause 120

Registered Pension Plans

ITA
147.1

Section 147.1 of the Act sets out rules that apply to registered pension plans. The amendments to this section simply conform the French to the English text and are applicable after 1988 - the effective date of the new rules that apply to such plans.

Clause 121

Life Insurance Policies

ITA
148

Section 148 of the Act provides for the inclusion of various amounts in computing a taxpayer's income for a taxation year in respect of certain life insurance policies.

Subclause 121(1)

ITA
148(2)

Subsection 148(2) of the Act treats, in certain situations, a life insurance policy as having been disposed of. The amendment to this subsection, which applies to dispositions occurring after 1989, extends the application of subsection 148(2) to amended subsection 20(20) in order to provide a deduction under that latter subsection in respect of income accrued but not received under certain annuities which are deemed to have been disposed of under the rule in subsection 148(2).

Subclause 121(2) and (3)

ITA
148(8) to (8.2)

Subsection 148(8) of the Act permits the transfer of a life insurance policy to the policyholder's spouse or child, where the spouse or child is the life insured under the policy, on a tax-deferred basis. There are no comparable provisions for the transfer, to a spouse or former spouse, of an annuity contract, or of a life insurance policy where the spouse is not the life insured.

Subsection 148(8) has been amended and subsections 148(8.1) and 148(8.2) have been added to the Act in order to provide that the transfer of a life insurance policy or an annuity contract to a spouse or former spouse may be made on the same tax basis as the transfer of capital property to any of these parties. New subsection 148(8.1) provides that an inter vivos transfer of a life insurance policy (which, by definition, includes an annuity contract) will be treated as a disposition for proceeds equal to the adjusted cost basis of the policy, unless the transferor elects in his or her return of income for the year of transfer not to have the provisions of the subsection apply. New subsection 148(8.1) also applies to the transfer of a policy where, in accordance with the applicable provincial law and as part of an order for support or maintenance, a court has directed that the policy be transferred to a person with whom the policyholder cohabited in a conjugal relationship before that time. Similarly, new subsection 148(8.2) provides "rollover" treatment with respect to dispositions to a spouse as a consequence of death, unless an election is made in the return of income of the deceased spouse for the year of death not to have the provisions of the subsection apply. These two subsections are intended to parallel subsection 70(6) and 73(1) of the Act which deal with testamentary and inter vivos transfers of property.

These amendments apply to transfers and dispositions occurring after 1989.

Subclauses 121(4) and (5)

ITA
148(9)(a)

Section 148 of the Act provides for the inclusion of various amounts in computing the income of a taxpayer for a taxation year in respect of certain life insurance policies. Subparagraphs 148(9)(a)(v.1) and (x) of the Act are amended, effective with respect to policies last acquired after 1989, to provide that they apply in respect of an annuity contract that would be subject to accrual taxation in the relevant year, were it not for the fact that it did not have an anniversary day in the year and while held by the taxpayer.

Clause 122

Exempt Taxpayers

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

Subclause 122(1)

ITA
149(1)(t)

Paragraph 149(1)(t) of the Act provides an exemption under Part I of the Act in respect of the taxable income of certain insurers for a period in which not less than 25 per cent of the gross premium income earned by the insurer and certain affiliated persons was from the insurance of residences and other property of farmers and fishermen ("farm risks"). The amendment to paragraph 149(1)(t) provides that, in the case of prescribed insurers, eligibility for this exemption will be determined without reference to the gross premium income (net of reinsurance ceded) of other insurers. New paragraph 149(1)(t) applies to the 1989 and subsequent taxation years.

Subclause 122(2)

ITA
149(4.1) to (4.3)

Subsection 149(4.1) of the Act limits the exemption provided under paragraph 149(1)(t) for a taxation year where not less than 25 per cent and not more than 90 per cent of an insurer's gross premium income (net of reinsurance ceded) was from the insurance of farm risks. In such a case, the exemption will be restricted to that portion of the insurer's taxable income for the year that the insurer's gross premium income (net of reinsurance ceded) earned for the year from the insurance of farm risks is of its total gross premium income (net of reinsurance ceded) earned for the year. In determining its taxable income for the purposes of this subsection, the insurer will be treated as having claimed or deducted in preceding taxation years the greater of its actual capital cost allowance and reserve claims and deductions and the amount which it was entitled to claim or deduct under paragraphs 20(1)(a), 20(7)(c) and 138(3)(a) and section 140 of the Act (to the extent of the insurer's taxable income otherwise determined for those preceding years). Subsection 149(4.1) is amended to delete the requirement to recompute an insurer's taxable income on the basis that the maximum capital cost allowance and reserve claims and deductions had been taken in preceding taxation years. This requirement is now provided in new subsection 149(4.3), and is generally applicable for the purposes of Part I.

Subsection 149(4.2) of the Act provides that all of an insurer's taxable income for a taxation year will be exempt where more than 90 per cent of the gross premium income (net of reinsurance ceded) earned by the insurer and all other insurers that were specified shareholders of, or were related to, the insurer (or, where the insurer is a mutual corporation, that were part of a group that controlled or were controlled by the insurer) was from the insurance of farm risks. The amendment to subsection 149(4.2) provides that, in the case of prescribed insurers, eligibility for this exemption will be determined without reference to the gross premium income (net of reinsurance ceded) of other insurers.

New subsection 149(4.3) of the Act provides that in determining, for the purposes of Part I, the taxable income of an insurer for a particular taxation year, the insurer will be treated as having claimed or deducted, in each preceding taxation year in respect of which any of its income was exempt by reason of paragraph 149(1)(t), the greater of its actual capital cost allowance and reserve claims and deductions and the maximum amount which it was entitled to claim or deduct under paragraphs 20(1)(a), 20(7)(c) and 138(3)(a) and section 140 of the Act (to the extent of its taxable income for the year before any such deductions or claims are taken into account). This subsection, which replaces the similar rule in existing subsection 149(4.1), is intended to ensure that an insurer does not accumulate or "bank" certain discretionary tax deductions in years in which it is exempt from tax on all or part of its taxable income.

New subsections 149(4.1) to (4.3) apply to the 1989 and subsequent taxation years.

Clause 123

ITA
149.1

Charities

Section 149.1 of the Act provides rules governing charitable organizations.

Subclause 123(1)

ITA
149.1(1)(e)(i)

Paragraph 149.1(1)(e) of the Act contains the definition "disbursement quota". Subparagraph (i) of this definition is amended for the 1988 and subsequent taxation years simply to correct references to the provisions that require official receipts for charitable donations made by individuals and corporations.

Subclause 123(2)

ITA
149.1(1)(e.1)(ii)

Paragraph 149.1(1)(e.1) defines the non-qualified investments of private charitable foundations. Subparagraph (ii) of this definition refers to "a qualifying share within the meaning assigned by subsection 192(6) if that subsection were read without reference to the words "after June 30, 1983 and before 1987"". Subsection 192(6) of the Act was subsequently amended to change the date referred to therein and, as a consequence, subparagraph 149.1(1)(e.1)(ii) is amended to make reference to the dates that are currently referred to in subsection 192(6).

This amendment applies to shares issued after May 22, 1985, other than shares issued before 1986 to which subsection 192(6), as it read on May 22, 1985, is applicable.

Subclause 123(3)

ITA
149.1(1)(e.1)

Part V of the Act imposes a tax on a corporation in certain circumstances when shares of the corporation are held by a private charitable foundation. This amendment to paragraph 149.1(1)(e.1), which applies to the 1983 and subsequent taxation years, provides that no Part V tax will be payable in circumstances where a private foundation owns all of the issued shares of a particular corporation.

Subclause 123(4)

ITA
149.1(6.4) and (6.5)

New subsection 149.1(6.4) of the Act provides that a national arts service organization that is designated by the Minister of Communications and registered by the Minister of National Revenue as meeting prescribed criteria shall be treated, for income tax purposes, as if it were a registered charity that is designated as a charitable organization. The criteria are to be prescribed in the Regulations and will include the following:

(1) the organization must be an organization

(a) that is, by reason of paragraph 149(1)(l) of the Act, not required to pay tax under Part I of the Act;

(b) which represents the community of artists from one or more of the following sectors of activity in the arts community in an official language of Canada: theatre, opera, music, dance, painting, sculpture, drawing, crafts, design, photography, the literary arts, film, sound recording and other audio-visual arts, and such other sectors as the Minister of Communications may recognize;

(c) no part of the income of which may be payable to, or otherwise available for, the personal benefit of any proprietor, member, shareholder, trustee, or settlor of the arts service organization except where the payment is for services rendered or is an amount to which paragraph 56(1)(n) of the Act applies in respect of the recipient;

(d) all of the resources of which are devoted to the activities and objects described in its application for its last designation by the Minister of Communications pursuant to subsection 149.1(6.4) of the Act;

(e) more than 50% of the directors, trustees, officers or like officials of which deal with each other and with each of the other directors, trustees, officers or officials at arm's length;

(f) no more than 50% of the property of which at any time may be contributed or otherwise paid into the organization by one person or members of a group of persons who do not deal with each other at arm's length and, for these purposes, a reference to any person or to members of a group does not include a reference to Her Majesty in right of Canada or a province, a municipality, or a registered charity (other than a private foundation or a club, society or association described in paragraph 149(1)(l)); and

(2) the activities of the organization must be confined to one or more of

(a) promoting of one or more art forms;

(b) conducting research into one or more art forms;

(c) sponsoring art exhibitions or performances;

(d) representing interests of the arts community or a sector thereof (but not of individuals) before legal or governing bodies;

(e) conducting workshops, seminars, training programs and similar development programs relating to the arts for members of the organization where such activity results in members including the value of the program in income under paragraph 56(1)(aa) of the Act;

(f) educating the public about the sector represented by the organization;

(g) organizing and sponsoring conventions, conferences, competitions and special events relating to the sector represented by the organization;

(h) conducting arts studies and surveys of interest to members of the organization relating to the sector represented by the organization;

(i) acting as an information centre by maintaining resource libraries and data bases relating to the sector represented by the organization;

(j) disseminating information relating to the sector represented by the organization; and

(k) paying amounts to which paragraph 56(1)(n) of the Act applies in respect of the recipient and which relate to the sector represented by the organization.

While the above activities would be permitted activities of a registered national arts service organization, the operations of the organization will be subject to the overriding considerations of those provisions of the Income Tax Act relating to registered charities. By reason of new subsection 149.1(6.4), those provisions will be made applicable to registered national arts service organizations, with such modifications as the circumstances require. An example of this interaction would arise where a registered national arts service organization engages in activities, such as those permitted in paragraph (2)(d) above, which may include political activities. Subsection 149.1(6.2) of the said Act, however, limits the extent to which a charitable organization may engage in political activities to an amount which is ancillary and incidental to its charitable activities. Accordingly, while a registered national arts service organization could engage in certain activities described in paragraph 2(d) above that could be considered to be political activities, the extent of such activities would, by reason of subsection 149.1(6.2) of the Act, be limited to activities that are ancillary and incidental to the activities of the organization.

New subsection 149.1(6.5) of the Act authorizes the Minister of Communications to revoke a designation of an organization as a national arts service organization and provides that, where this is done, the registration of the organization as a registered national arts service organization may also be revoked.

New subsections 149.1(6.4) and (6.5) of the Act are applicable after July 13, 1990 except that, where an organization has applied to the Minister of National Revenue for registration before the date these provisions receive Royal Assent, and is subsequently accepted for registration, the organization shall be deemed to have become registered on the day the application for registration of the organization was made or on such later day as is specified in the application for registration.

Subclause 123(5)

ITA
149.1(9)

Subsection 149.1(9) of the Act treats property accumulated by a charity for a particular purpose accepted by the Minister of National Revenue, but not used by the charity for that purpose, to be income for the purposes of calculating its disbursement quota. This amendment, which applies to the 1988 and subsequent taxation years, simply corrects a reference to the provision relating to official receipts for charitable donations made by corporations.

Clause 124

Returns

ITA
150(1)(b)

Subsection 150(1) of the Act requires taxpayers to file their income tax returns on or before specified dates. Where a taxpayer dies before filing a return, the legal representative of the taxpayer is given 6 months from the date of death to file the return under paragraph 150(1)(b).

Paragraph 150(1)(b) is amended to apply only in respect of returns for a year where a taxpayer has died after October 31 in the year and before May 1 in the following year. In these circumstances, whether or not the taxpayer actually filed the return for the year, the legal representative of the taxpayer continues to be permitted to file the taxpayer's return for the year up to 6 months after the date of death. As a consequence, it is clear that paragraph 150(1)(d) will apply in the case of terminal returns for individuals who die in the first 10 months of a year so that such returns are not required to be filed until April 30 in the following year. As it relates to the filing deadline for terminal returns, the amendment is consistent with Revenue Canada's existing administrative practice.

EXAMPLE

Ms. A dies on March 15, 1991. She did not file income tax returns for the 1989 and 1990 years. Amended paragraph 150(1)(b) of the Act ensures that Ms. A's death does not result in an extension of the date on which the 1989 income tax return was due (April 30, 1990). The 1990 income tax return would be due on September 15, 1991 (6 months after the date of death). The terminal return for 1991 would be due April 30, 1992.

This amendment applies with respect to deaths occurring after October 1990.

Clause 125

Assessments

ITA
152

Section 152 of the Act contains rules relating to assessments and reassessments of tax, interest and penalties payable by a taxpayer and to determinations and redetermination of amounts of tax deemed to have been paid by a taxpayer.

The time within which the Minister of National Revenue may generally reassess or make a redetermination is known as the "normal reassessment period". For an individual or a testamentary trust that period is the three years beginning after the day of mailing of a notice of an original assessment for the relevant year or the day of mailing of a notification that no tax is payable for that year.

Subclause 125(1)

ITA
152(3.1)

Subsection 152(3.1) of the Act, which defines a taxpayer's "normal reassessment period" for a taxation year, is amended, applicable to assessments and redeterminations made in respect of the 1985 and subsequent taxation years, to have that definition apply to new subsection 152(4.2).

Subclause 125(2)

ITA
152(4.2)

The purpose of new subsection 152(4.2) of the Act, applicable to assessments and redetermination made in respect of the 1985 and subsequent taxation years, is to give the Minister of National Revenue discretion to make a reassessment or a redetermination beyond the normal reassessment period when so requested by a taxpayer who is an individual or a testamentary trust in order to give the taxpayer a refund, or to reduce taxes payable. Thus, for example, if, after the expiration of the normal reassessment period an individual became aware that a claim for a deduction or a credit to which the individual was entitled was inadvertently not made, the Minister would have the discretion to reassess the return and give the taxpayer the benefit of the deduction or credit.

A reassessment or redetermination to create a refund or reduce taxes payable will generally be made upon receipt of a written request made after the normal reassessment period by an individual or a testamentary trust where the Minister is satisfied that the request for the adjustment would have been processed if it had been made within the normal reassessment period.

The Minister will issue guidelines to describe in more detail the circumstances in which a request for a reassessment for a refund or a reduction of taxes payable may be granted.

The guidelines will also explain the manner in which the application should be made. Reference may also be made to the commentary to new subsection 164(1.5) of the Act.

Clause 126

Withholding

ITA
153

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

Subclause 126(1)

ITA
153(1)(f)

Although paragraph 153(1)(f) of the Act authorizes the withholding of tax from "an annuity payment", this term may not be sufficient to cover commutation payments under annuity contracts. The amendment to this paragraph ensures that there is authority for requiring the withholding of tax in respect of commutation payments made after July 13, 1990.

Subclause 126(2)

ITA
153(1)(l)

Paragraph 146(12) of the Act provides that where a retirement savings plan has been accepted for registration but is subsequently revised or amended so that it no longer complies with the requirements for registration, the amended plan will be deemed not to be a registered retirement savings plan ("RRSP"). Similarly, section 146.3(11) of the Act provides that where a retirement income fund has been accepted for registration but is later revised or amended so that it does not comply with the requirements for registration, the amended fund will be deemed not to be a registered retirement income fund ("RRIF").

While paragraph 153(1)(j) of the Act provides that a payment out of or under an RRSP or a plan referred to in subsection 146(12) of the Act as an "amended plan" is subject to the withholding requirements imposed under subsection 153(1), paragraph 153(1)(l) refers only to a payment out of or under an RRIF and not to an "amended fund". This amendment to paragraph 153(1)(l), which applies to payments made after July 13, 1990, authorizes the withholding of tax from payments out of or under an amended fund. It is intended that the Regulations will also be amended, effective as of the same date, to require withholding in respect of payments from a fund referred to in subsection 146.3(11) of the Act as an amended fund.

Subclause 126(3)

ITA
153(1)(m.1)

A legislative amendment to the Department of Labour Act, enabling the Minister of Labour to provide income assistance to eligible older workers under the Program for Older Worker Adjustment, received Royal Assent in June, 1989. This consequential amendment to subsection 153(1) of the Act, which applies to payments made after July 13, 1990, confirms that any person making such income assistance payments will be required to withhold tax from such payments, in accordance with Part I of the Regulations.

Subclause 126(4)

ITA
153(2)

Subsection 153(2) of the Act, in conjunction with subsections 155(1) and 156(1), has the effect of relieving individuals from the obligation to pay instalments of income tax for a taxation year where the individual's income from which tax has been withheld at source is at least 75% of the individual's total income for the year. In such a case, the individual is required to pay his or her income tax balance on or before April 30 of the following year.

Subsection 153(2) is amended to require the payment of the tax payable for a year by the individual's "balance due day" for the year. The expression "balance due day" is newly defined in subsection 248(1). For most individuals the "balance due day" for a taxation year is April 30 of the following year and coincides with the normal deadline for filing the individual's income tax return for the year. Where an individual died after October 31 in the year and before May 1 in the following year, the individual's balance due day is extended to six months following the date of death. For inter vivos trusts the balance due day is 90 days after the end of their year.

The amendment to this subsection is applicable to the 1990 and subsequent taxation years.

Clauses 127 and 128

Instalments of Tax

ITA
155(1) and 156(1)

Subsections 155(1) and 156(1) of the Act provide rules for the payment of income tax instalments by individuals who are not exempted from the payment of instalments under subsection 153(2) or section 156.1. Subsection 155(1) applies to individuals whose chief source of income is farming and fishing and generally provides for the payment of two-thirds of an individual's tax in respect of a taxation year on or before December 31 of the year, with the remainder to be paid on or before April 30 of the following year. Subsection 156(1) applies in other cases and generally provides for quarterly instalments of an individual's tax in respect of a taxation year on or before March 15, June 15, September 15 and December 15 of the year, with the remainder to be paid on or before April 30 of the following year.

These provisions are amended for the 1990 and subsequent years in the same manner as subsection 153(2), to refer to the individuals "balance due day". The effect of these amendments is described in the commentary on the amendments to subsection 153(2).

Clause 129

Exemption from Instalments

ITA
156.1

Section 156.1 of the Act relieves individuals (including inter vivos trusts) from any obligation to pay instalments where the income tax payable in respect of a taxation year is $1,000 or less. In such a case, the individual is required to pay his or her tax balance on or before April 30 of the following year.

Section 156.1 is amended so that individuals to whom the rule applies are required to have their tax balances paid on or before their "balance due day" for the year. As newly defined in subsection 248(1), the "balance due day" of most individuals for a taxation year is April 30 of the following year and coincides with the normal filing deadline for the individual's income tax return for the year. The balance due day is extended where an individual dies, and is 90 days after the year-end for inter vivos trusts. This amendment is consistent with the amendments to subsection 153(2), 155(1) and 156(1) which are discussed earlier in the commentary.

Section 156.1 is also amended so that the legal representative of an individual is not required to remit income tax instalments that would otherwise become due after the death of the individual. This is consistent with Revenue Canada's current administrative practice.

In addition, the amendments to section 156.1 clarify that instalment interest for a taxation year may not be eliminated by the carryback of a loss or other amount that reduces the tax payable for the year or the immediately preceding taxation year to $1,000 or less.

These amendments are applicable to the 1990 and subsequent taxation years and with respect to losses and other amounts carried back that arise in the 1990 and subsequent taxation years.

Clause 130

Tax Payments by Corporations

ITA
157(2.1)(a)

Paragraph 157(2.1)(a) of the Act provides that where a corporation's tax payable for the year under Parts I, I.3 and VI.1 is $1,000 or less, the corporation is exempt from the requirement to make instalment payments. The Part I tax is the normal corporate income tax. Part I.3 tax is the special tax on large corporations and the Part VI.1 tax is the special tax on dividends paid on taxable preferred shares. Paragraph 157(2.1)(a) is amended to delete the reference to Part I.3. As a result, instalments are not required where the aggregate of a corporation's tax payable under Parts I and VI.1 is not more than $1,000.

Paragraph 157(2.1)(a) is also amended to clarify that instalment interest for a taxation year may not be eliminated by the carryback of a loss or other amount that reduces the tax payable for the year or the immediately preceding taxation year to $1,000 or less.

These amendments are applicable to the 1990 and subsequent taxation years and with respect to losses and other amounts carried back that arise in the 1990 and subsequent taxation years.

Clause 131

Certificates

ITA
159(2)

Subsection 159(2) of the Act requires certain persons who are responsible for administering, winding-up, controlling or otherwise dealing with the property, business or estate of another person to obtain, prior to making a distribution of any property over which that person has control, a certificate from the Minister of National Revenue verifying that all amounts for which any taxpayer is liable under the Act, and for the payment of which that person is or may be liable in the capacity of responsible representative, have been paid or that acceptable security for payment has been provided.

This amendment, which applies with respect to applications made after Royal Assent, provides that an application for the certificate required under subsection 159(2) is to be made in prescribed form.

Clause 132

Excess Refunds

ITA
160.1

Section 160.1 of the Act provides that an amount refunded to a taxpayer in excess of that to which he was entitled under the Act is to be treated as an amount payable by the taxpayer on the day it was refunded and will be subject to interest at the prescribed rate from that day to the date on which it is repaid.

The amendment to paragraph 160.1(1)(b), which applies to the 1989 and subsequent taxation years, ensures that no interest is charged on that portion of the excess refund that represents a repayment of the goods and services tax credit.

New subsection 160.1(4), which applies to the 1990 and subsequent taxation years, provides that section 160.1 will also apply where an amount in excess of that to which a taxpayer was entitled as a refund is instead applied as an offset to a liability of the taxpayer.

Clause 133

Interest on Unpaid Taxes

ITA
161

Section 161 of the Act provides for interest to be payable by taxpayers with respect to their income tax arrears for a taxation year, including income tax instalment arrears.

Subclause 133(1)

Interest on Instalments

ITA
161(2.1)

Subsection 161(2) of the Act provides that a taxpayer is liable to pay interest on unpaid instalments of taxes under Part I of the Act. Subsection 161(2.1) restricts this liability by prohibiting the Minister from assessing interest in cases where the interest liability on both federal and provincial taxes would not exceed $25.

The amendment to 161(2.1), applicable upon Royal Assent, clarifies that the restriction to interest liability contained therein applies to amounts paid or payable under the Canada Pension Plan by virtue of section 36 of that Act.

Subclause 133(2)

ITA
161(2.2)(b)

Subsection 161(2.2) of the Act provides for a reduction in arrears interest where the taxpayer has remitted income tax instalments earlier than the taxpayer was required to do so or in larger amounts than were required. For an individual, the period in respect of which "offset" interest is computed under subsection 161(2.2) commences on January 1 of the taxation year to which the early or excessive tax payments relate and ends on April 30 of the following year.

Although the period for the computation of "offset" interest ends for an individual on April 30 following the relevant taxation year, the individual is entitled to receive interest under subsection 164(3) with respect to excessive amounts paid on account of income tax for the period after that date. In the case of an individual, such "refund" interest for a taxation year is generally determined in respect of the period commencing on the day the income tax return is required to be filed and ending at the time that the tax and interest is refunded.

Subsection 161(2.2) is amended so that the period for the computation of "offset" interest for a taxation year for a deceased individual or an inter vivos trust extends to the "balance due day" for the year rather than to April 30 following the year. As defined in subsection 248(1), the "balance due day" of a trust or deceased individual for a taxation year coincides with the normal deadline for filing the income tax return for the year. This ensures that "offset" interest under subsection 161(2.2) and "refund" interest under subsection 164(3) may be determined in respect of successive and non-overlapping periods of time for deceased individuals and inter vivos trusts.

This amendment applies to the 1990 and subsequent taxation years.

Subclause 133(3)

ITA
161(3)

Subsection 157(2) of the Act relieves a cooperative corporation or credit union from the obligation of making instalment payments of its tax under Part I in a taxation year where its taxable income did not exceed $10,000, and no tax was payable by it under Part VI.1, for that year or its immediately preceding year. Subsection 161(3) of the Act charges interest for a taxation year where a corporation that paid tax under subsection 157(2) had taxable income of more than $10,000 for the year or had a tax payable for the year under Part VI.1 -- the special tax on dividends paid on taxable preferred shares. Since the charge imposed under subsection 161(3) could exceed the interest that would be payable by a corporation under the general corporate instalment provisions in subsection 157(1) (for example, where a corporation had tax payable under Part I or VI.1 of the Act for the current year but none in respect of the preceding year), this subsection is to be repealed with respect to the 1988 and subsequent taxation years.

Subclause 133(4)

ITA
161(11)

Subsection 161(11) of the Act requires the payment of interest on penalties imposed under the Act. This subsection is amended, as a consequence of the introduction of new section 235 -- which provides for a penalty for failing to file corporate returns -- to specify the means by which interest on such a penalty will be computed. This amendment will take effect on Royal Assent.

Clause 134

Penalties

ITA
162

Section 162 of the Act imposes penalties for such infractions as failing to provide certain information or failing to file a return for a taxation year.

Subclauses 134(1) and (2)

ITA
162(5) and (6)

Subsections 162(5) and (6) of the Act are amended to delete the authority of the Minister of National Revenue to waive a penalty with respect to an individual's failure to provide either information on a prescribed form or a Social Insurance Number as required by the Act. As new subsection 220(3.1) gives the Minister discretion to cancel or waive any penalty payable under the Act by a taxpayer or partnership, this discretion is no longer necessary under subsections 162(5) and (6).

The amendments to subsections 162(5) and (6) are applicable upon Royal Assent.

Subclause 134(3)

ITA
162(11)

Subsections 162(1) and (2) of the Act provide penalties for a person's failure to file a return for a taxation year. These penalties are computed on the basis of the person's tax for the year that was unpaid at the time the return was due. New subsection 162(11) clarifies that, for the purpose of computing the amount of such penalties, the person's tax for the year is to be determined without reference to deductions that arise from subsequent years' events, such as loss carrybacks from subsequent years or unused foreign tax credits for subsequent years. This amendment is applicable with respect to carrybacks from taxation years ending after July 13, 1990.

Clause 135

Penalties

ITA
163

Section 163 of the Act imposes penalties in respect of more serious failures such as making false statements or omitting to report income.

Subclause 135(1)

ITA
163(2.3)

New subsection 163(2.3) of the Act provides a penalty where a taxpayer knowingly, or under circumstances amounting to gross negligence, makes a false statement or omission in a prescribed form relating to the allocation of assistance in respect of exercises expenditures under new subsections 66(12.691) or (12.701). The penalty is 25% of the under-reported amount of such assistance. This amendment is applicable after Royal Assent.

Subclause 135(2)

ITA
163(4)

Subsection 163(2) of the Act provides a penalty for understating income in a return for a taxation year. This penalty is based, in part, on the amount of the understatement of income for the year in question. New subsection 163(4) is intended to clarify that, in determining the understatement of a person's income for a year, his income is to be computed without reference to certain deductions that arise from subsequent years' events, such as listed-personal-property loss carrybacks from subsequent years.

This amendment applies with respect to amounts referred to in new subsection 163(4) in respect of subsequent taxation years ending after July 13, 1990.

Clause 136

Refund of Taxes

ITA
164

Section 164 of the Act relates to tax refunds. Subsection 164(1) precludes the Minister of National Revenue from refunding an overpayment of tax for a taxation year to a taxpayer unless the taxpayer's tax return for the year was filed within three years from the end of the year.

Subclause 136(1)

ITA
164(1.5)

New subsection 164(1.5) of the Act, applicable with respect to refunds for the 1985 and subsequent taxation years, gives the Minister discretion to refund to an individual or a testamentary trust all or any portion of the overpayment of tax for a taxation year even where the taxpayer's tax return for the taxation year was filed later than three years after the end of taxation year.

New subsection 164(1.5) also permits the Minister to refund all or any portion of an overpayment to which an individual or testamentary trust may be entitled as a consequence of a requested adjustment which is made after the normal three year re-assessment period. In this regard, reference may be made to the commentary to new subsections 152(4.2) and 220(3.4) of the Act.

In most circumstances, a refund will be made to a taxpayer under this new subsection where the Minister is satisfied that it would have been made had the taxpayer's return been filed on time or the request for an adjustment been made on a timely basis and that the resulting assessment would be correct in law. Guidelines will be issued by the Minister to explain in more detail when the discretion granted under this subsection will be exercised as well as the manner in which to apply for a refund. For example, it is recognized that records may not always be available and it may be difficult to construct a taxpayer's return for one or more years in respect of the claim. The taxpayer's assistance will be required in this regard. Depending on the adequacy of the records and the validity of the claim, a refund may be granted.

Consideration will be given by the Minister to give a refund upon application being made in writing and in the manner set out in the guidelines. The taxpayer will be required to explain in the application why the refund should be granted.

There will be circumstances where the amount of any refund which an individual or testamentary trust might otherwise receive may be reduced. This could occur, for example, where an adjustment requested by a taxpayer under new subsection 152(4.2) would result in a refund for a particular year, but the adjustment would have otherwise necessitated increasing the taxes, interest or penalties payable in respect of another year which may not be reassessed because the normal reassessment period for that year had expired. Since these new provisions do not grant the Minister authority to increase taxes after expiration of the normal reassessment period, the refund in such circumstances will be granted only to the extent that it exceeds the taxes, interest and penalties that would otherwise have been payable if the other year had been open for reassessment.

Subclause 136(2)

ITA
164(2)

Subsection 164(2) of the Act allows the Minister of National Revenue to offset any tax refund otherwise payable to a taxpayer against any other liability of the taxpayer under the Act. The amendment to this provision authorizes the Minister to apply any such refund against any other amount that is owed or is about to become owed by the taxpayer to Her Majesty in right of Canada. This amendment is effective on Royal Assent.

Subclause 136(3)

ITA
164(3.1)

Subsection 164(3.1) of the Act provides for the recovery of excess interest paid on a refund to, or applied to reduce a liability of, a taxpayer as a result of an overpayment of tax, where it is subsequently determined that the refund or reduction of liability was in excess of the amount to which the taxpayer was entitled. This subsection is amended, applicable with respect to refunds for the 1985 and subsequent taxation years, to provide for the recovery of the excessive interest paid or applied pursuant to new subsection 164(3.2).

Subclause 136(4)

ITA
164(3.2)

New subsection 164(3.2) of the Act, applicable with respect to refunds for the 1985 and subsequent taxation years, authorizes the Minister of National Revenue to pay interest on an amount refunded to a taxpayer by reason of new subsection 164(1.5), or to apply interest to another liability of the taxpayer where the amount of the refund is applied to reduce that liability by reason of subsection 164(2). This new subsection overrides the rule in subsection 164(3) of the Act concerning the computation of interest and provides that interest will be computed from the day the Minister receives an acceptable request for an adjustment to the day the amount is refunded or applied, as the case may be.

Clause 137

Child Tax Credit Prepayment

ITA
164.1

Section 164.1 of the Act provides for the prepayment of up to two-thirds of the refundable child tax credit.

Paragraph 164.1(1)(a) of the Act provides for a higher prepayment of the refundable child tax credit in respect of an eligible child under 6 years of age at the end of the preceding year since a special additional credit of up to $200 (indexed) in addition to the normal credit of $559 (indexed), is provided for such a child. Where child care expenses are claimed in respect of the child, an amount equal to 25% of these expenses is applied in reduction of the additional credit. Where child care expenses have been claimed for the preceding year in respect of one or more children of the individual eligible for the prepayment, it is not always possible, at the time of the prepayment, to ascertain whether the child care expenses have been claimed in respect of the particular child in respect of whom a higher prepayment of the credit is contemplated. The amendment to paragraph 164.1(1)(a) - which is made for the purpose of determining entitlement to a prepayment of the credit and not entitlement to the credit itself - provides that, where child care expenses were claimed in the preceding year in respect of any child of the individual under 6 years of age at the end of that year, no prepayment will be made to the individual with respect to the special additional credit of $200. This amendment applies to the 1989 and subsequent taxation years.

Clause 138

Objections to Assessments and Determinations

Section 165 of the Act provides rules governing a taxpayer's right to object to an assessment or determination by the Minister of National Revenue of tax, interest, penalties and certain other amounts under the Act.

Subclause 138(1)

ITA
165(1)

Under subsection 165(1) of the Act a taxpayer has a right to object to an assessment for a taxation year within 90 days from the day of mailing of the notice of assessment for the year. This subsection is amended to extend the time for objecting to an assessment in the case of individuals and testamentary trusts. For objections filed after Royal Assent, such taxpayers will have the right to object to an assessment within one year after the filing due date of the return for the taxation year or within 90 days after the day of mailing of a notice of assessment in respect of the year, whichever is later.

The subjection is also amended to remove the requirement that an objection must be made in duplicate and in prescribed form.

ITA
165(1.1)

Under subsection 165(1) of the Act, a taxpayer who wishes to object to an assessment or determination may serve a notice of objection on the Minister within 90 days from the day on which the notice of assessment or determination was mailed to him. Where the Minister issues a notice of assessment or a determination pursuant to subsection 67.5(2), subparagraph 152(4)(b)(i) or subsection 152(6), 164(4.1), 220(3.4) or 245(8) or in accordance with an order of a Court, pursuant to subsection 165(3) where the underlying objection relates to those provisions or circumstances or pursuant to other statutory provisions authorizing reassessments beyond the normal reassessment period, the taxpayer may, through the application of subsection 165(1), attempt to object with respect to issues other than those raised in the assessment or determination. New subsection 165(1.1) restricts the matters to which the taxpayer may object in such cases to those which gave rise to the assessment or determination. This new subsection applies with respect to objections filed after Royal Assent.

However, the restrictions do not apply if, at the time of issuing an assessment or making a determination under any of the provisions or circumstances mentioned in subsection 165(1.1), a prior assessment or determination not itself subject to the limitation, was under objection or the time to object had not expired.

For example, where a taxpayer makes a request which results in a reassessment being issued pursuant to subsection 152(6) before an objection to a prior assessment, issued other than pursuant to the provisions or circumstances mentioned in subsection 165(1.1), is finalized, or the time to object to such an assessment had not expired, the limitation referred to in subsection 165(1.1) does not apply. In the first situation, the taxpayer must file either a new notice of objection or an appeal in order to continue to dispute the issues raised in the prior assessment. In the latter situation, the taxpayer may serve a notice of objection to the 152(6) reassessment and therein also dispute the issues raised in the prior assessment as well.

(Similar rules for appeals from assessments and determinations are described in the commentary on section 169.)

ITA
165(1.2)

New subsection 165(1.2) of the Act, applicable after 1990, precludes an individual or a testamentary trust from objecting to an assessment made under new subsection 152(4.2).

The provision of Ministerial discretion in new subsections 152(4.2) and 164(1.5) is intended to enable the Minister to provide relief in situations where an individual or a testamentary trust would have received a refund or reduction had the application therefor been made within the period of time otherwise required by the Act. However, it is not intended, as a result of the exercise of this discretion, to extend the right to object in respect of matters such as valuations or interpretations of the law.

The discretion provided to grant refunds or reductions of liabilities to a taxpayer in respect of an adjustment requested after the normal reassessment period must be exercised by the Minister in a reasonable, fair and consistent manner. If a taxpayer believes that the Minister has not so exercised the discretion, the taxpayer may challenge the manner in which the discretion has been exercised.

ITA
165(2) and (2.1)

Subsection 165(2) of the Act is amended to provide that objections filed after Royal Assent are to be addressed to the Chief of Appeals in a District Office or a Taxation Centre of Revenue Canada, Taxation and also to remove the requirement that such objections are to be sent by registered mail.

New subsection 165(2.1) of the Act, applicable for objections filed after Royal Assent, provides that the extension of time to object to an assessment contained in the amendment to subsection 165(1) applies only in respect of assessments and determinations under Parts I, I.1 (the individual surtax) and I.2 (the tax on family allowances and old age security benefits in excess of certain threshold amounts).

Subclause 138(2)

ITA
165(6)

Subsection 165(6) of the Act provides that the Minister of National Revenue may accept an objection even if it is not made in the manner set out in the Act. This subsection is amended, applicable to objections filed after Royal Assent, as a consequence of the amendment to subsection 165(1) removing the requirement that an objection be made in duplicate.

Subclause 138(3)

ITA
165(7)

Subsection 165(7) of the Act provides that where a taxpayer has served a notice of objection to an assessment in respect of a taxation year and the Minister of National Revenue subsequently reassesses the taxpayer's tax for that year, the taxpayer may appeal the reassessment to the Tax Court of Canada without first serving a notice of objection to the reassessment. This amendment to subsection 165(7), which is applicable to the 1986 and subsequent taxation years, provides that a taxpayer may also appeal directly to the Tax Court where the reassessment in question relates to other amounts such as interest or penalties.

Clause 139

Extensions of Time

ITA
166.1 to 167

New sections 166.1, 166.2 and 167 of the Act modify the provisions governing applications for extensions of time for objecting to, or appealing from, assessments of tax. There are two significant changes.

First, in the case of applications to extend the time for making objections or requests under subsection 245(6) there will be a two-tier application process. Currently, under section 167 of the Act, all applications are made to the Tax Court of Canada. Under these amendments the applications will first be made to the Minister of National Revenue who may grant the application if the applicant can demonstrate that the requirements of the section are met. If the Minister refuses the application, the applicant may make a further application to the Tax Court of Canada.

Time extension requests with respect to notices of appeal will continue to be made directly to the Tax Court of Canada.

The second change concerns the requirements for obtaining an extension. The new wording provides that the applicant must demonstrate that during the period when he could have objected or appealed he must either have been unable to act or to instruct someone else to act in his name or he must have had a bona fide intention to object, appeal or make the request.

Extension of Time by Minister

ITA
166.1

New section 166.1 of the Act allows a taxpayer to apply to the Minister of National Revenue for an extension of time to object to an assessment or make a request under subsection 245(6) of the Act. The application must set out the reasons why no objection or request was made during the time allowed for doing so and must be addressed to the Chief of Appeals in a District Office or Taxation Centre.

The Minister must consider the application and either grant or refuse an extension of time. When an extension is granted the notice of objection is considered to have been filed on the day the Minister's decision is mailed.

No extension may be granted unless the application was made within one year of the time limit for objecting or making a request. In addition, the taxpayer must demonstrate that he was unable to object or have someone else act for him, or he had a bona fide intention to object or make a request. Finally, under section 166.1 in order for an application to succeed the taxpayer must show that it would be just and equitable to grant the extension and the application was made as soon as circumstances permitted.

ITA
166.2

If the Minister refuses an application for an extension of time to object to an assessment under section 166.1 of the Act or more than 90 days have elapsed since an application was made under section 166.1, the taxpayer may make a further application to the Tax Court of Canada under section 166.2. Such an application may not be made more than 90 days after the Minister mails to the taxpayer his decision on the application under section 166.1.

The Tax Court may dismiss or grant the application and, in granting an application, may impose terms. No application may be granted unless the applicant meets the same conditions as in section 166.1.

Extension of Time to Appeal

ITA
167

Section 167 of the Act allows a taxpayer to apply to the Tax Court of Canada for an order extending the time for filing a notice of appeal. If the Court grants the application it may impose terms.

No extension shall be granted unless the application was made within one year of the expiration of the time limit for filing a notice of appeal. In addition, the taxpayer must demonstrate that he was unable to appeal or have someone act for him or he had a bona fide intention to object or make a request.

Finally, in order for an application to succeed under section 167 the taxpayer must show that it would be just and equitable to grant the extension, the application was made as soon as circumstances permitted and there are reasonable grounds for the appeal.

The modification to section 167 and new sections 166.1 and 166.2 will come into force with respect to applications filed after 30 days following Royal Assent.

Clause 140

Appeals to Tax Court of Canada

ITA
169

Section 169 of the Act provides that a taxpayer may, after having served a notice of objection, appeal to the Tax Court of Canada after either the Minister has confirmed the assessment or reassessed or 90 days have elapsed since the service of the notice of objection and the Minister has not notified the taxpayer he has vacated or confirmed the assessment or reassessed.

ITA
169(1) and (2)

Section 169 of the Act is being reenacted as subsection 169(1). It provides that a taxpayer may, under certain conditions, institute an appeal to have an assessment vacated or varied.

Where the Minister issues a notice of assessment or a determination pursuant to subsection 67.5(2), subparagraph 152(4)(b)(i) or subsections 152(6), 164(4.1), 220(3.4) or 245(8), or in accordance with an order of a Court, pursuant to subsection 165(3) where the underlying objection relates to those provisions or circumstances or pursuant to other statutory provisions authorizing reassessments beyond the normal reassessment period, the taxpayer may, through an appeal made under subsection 169(1), appeal with respect to issues other than those raised in the assessment or determination. New subsection 169(2), application to appeals from assessments or determinations objected to after Royal Assent, restricts the matters to which the taxpayer may appeal in such cases to those which gave rise to the assessment or determination.

However, the restrictions do not apply if, at the time of issuing an assessment or making a determination under any of the provisions or circumstances mentioned in subsection 169(2), a prior assessment or determination not itself subject to the limitation, was under appeal or the time to appeal had not expired.

For example, where a taxpayer makes a request which results in a reassessment being issued pursuant to subsection 152(6) before an appeal to a prior assessment (issued other than pursuant to the provisions or circumstances mentioned in subsection 169(2)) is disposed of, or the time to appeal to such an assessment had not expired, the limitation referred to in subsection 169(2) does not apply. In those circumstances, the taxpayer is not prevented from disputing or continuing to dispute the issues raised in the prior assessment in the manner provided in subsection 165(7).

(Similar rules for objections to assessments and determinations are described in the commentary on section 165).

Clause 141

Appeals to Federal Court of Canada

ITA
172(3)(a)

Paragraph 172(3)(a) of the Act provides a taxpayer with a right of appeal to the Federal Court of Appeal where the Minister of National Revenue has refused to accept its application for registration as a charity. This paragraph is amended, applicable after 1989, to clarify that such a right of appeal also exists for a registered charity the registration of which the Minister intends to revoke under subsection 149.1(2), (3), (4) or (4.1) of the Act.

Clause 142

Rules re: Appeals to Federal Court

ITA
180(1)(b)

Section 180 of the Act sets out rules governing appeals to the Federal Court of Appeal of certain decisions made and actions taken by the Minister of National Revenue. Paragraph 180(1)(b) is amended, applicable after 1989, to clarify that these rules also apply in respect of the Minister's decision to revoke the registration of a charity under subsection 149.1(2), (3), (4) or (4.1) of the Act.

Clause 143

Individual Surtax

ITA
180.1

Section 180.1 of the Act levies a surtax on individuals at a rate of 5% of tax payable under Part I of the Act. Individuals whose tax payable under Part I for a taxation year exceeds $15,000 are required to pay an additional surtax on the excess. This amendment, which applies to the 1991 and subsequent taxation years, increases the rate of the additional surtax from 3% to 5% and reduces from $15,000 to $12,500 the tax threshold used for the purposes of determining the excess on which the additional surtax is computed.

Clause 144

OAS/FA Benefit Repayment

ITA
180.2

Section 180.2 of the Act provides for the repayment by an individual of family allowance and old age security benefits included in computing the individual's income under Part I for the year, to the extent that the taxpayer's income is in excess of a $50,000 (indexed) threshold. This amendment, which applies to the 1989 and subsequent taxation years, excludes from the computation of the individual's income for the purposes of the repayment of those benefits capital gains realized on mortgage foreclosures.

Clause 145

Part I.3 - Definitions

ITA
181(1)

Subsection 181(1) of the Act defines the term "financial institution" for the purposes of the Part I.3 tax on large corporations. This amendment, which applies to taxation years ending after June 1989, extends this definition to include mortgage investment corporations, and deletes the reference to deposit insurance corporations which are, as a consequence of an amendment to subsection 181.1(3) of the Act, exempt from the Part I.3 tax.

Clause 146

Part I.3 - Tax Payable

ITA
181.1

Part I.3 of the Act levies an annual tax on a corporation's taxable capital employed in Canada in excess of $10 million.

Subclause 146(1)

ITA
181.1(1)

This amendment to subsection 181.1(1) of the Act changes the rate of tax payable under Part I.3 of the Act from 0.175% to 0.2%. This amendment applies to the 1991 and subsequent taxation years, but is subject to a transitional provision which maintains the 0.175% tax rate under Part I.3 for that portion of a corporation's 1991 taxation year that falls in 1990.

Subclause 146(2)

ITA
181.1(3)

Subsection 181.1(3) of the Act provides that certain corporations are exempt from tax under Part I.3. This amendment, which applies to taxation years ending after June 1989, extends this exemption to deposit insurance corporations (as defined in section 137.1 of the Act).

Clause 147

Part I.3 - LCT - Taxable Capital

ITA
181.2

Section 181.2 of the Act provides rules for determining the capital, taxable capital, taxable capital employed in Canada and investment allowance of corporations (other than financial institutions) resident in Canada for the purposes of the Part I.3 tax on large corporations.

Subclause 147(1)

ITA
181.2(3)

Subsection 181.2(3) of the Act defines the "capital" of a corporation (other than a financial institution or a corporation not resident in Canada) for the purposes of Part I.3. Subsection 181.2(3) is amended, applicable to taxation years ending after June 1989, to provide a deduction in computing a corporation's capital for a taxation year in respect of patronage dividends for which a deduction was taken under subsection 135(1) in computing the corporation's income under Part I for the year. This deduction is available only to the extent that the amount deducted under subsection 135(1) was otherwise included in computing the corporation's capital for the year.

Subclause 147(2) and (3)

ITA
181.2(4) and (5)

Subsections 181.2(4) and (5) of the Act define the investment allowance of a corporation (other than a financial institution or a non-resident corporation) for a taxation year under Part I.3 of the Act. These amendments provide, effective for taxation years ending after June 1989, that an investment allowance will also be available in respect of accrued dividends which the corporation has recorded as an asset at the end of the year. These amendments are also intended to ensure that an investment allowance is not provided in respect of other corporations which are resident or carry on business in Canada but are exempt from tax under Part I.3.

Clause 148

Part I.3 - Financial Institutions

ITA
181.3

Section 181.3 of the Act provides rules for determining the capital, taxable capital, taxable capital employed in Canada and investment allowance of financial institutions (as defined in subsection 181(1)) for the purposes of the Part I.3 tax on large corporations.

Subclause 148(1)

ITA
181.3(3)(a)

Subsection 181.3(3) defines the "capital" of a financial institution for the purposes of Part I.3. Subsection 181.3(3) is amended, applicable to taxation years ending after June 1989, to provide a deduction in computing a corporation's capital in respect of amounts deducted under subsection 130.1(1) by a mortgage investment corporation or 137(2) by a credit union in computing the corporation's income for the year. This deduction is available only to the extent that the amount deducted under subsection 130.1(1) or 137(2) was otherwise included in computing the corporation's capital for the year.

Subclause 148(2)

ITA
181.3(3)(d)

The French version of subparagraph 181.3(3)(d)(i) of the Act is amended, effective for taxation years ending after June 1989, to ensure that the English and French versions correspond in meaning.

Subclauses 148(3) to (5)

ITA
181.3(4)

Subsection 181.3(4) of the Act, which defines the investment allowance of a financial institution for a taxation year for the purposes of Part I.3 of the Act, is amended to provide, effective for taxation years ending after June 1989, that no allowance is to be provided in respect of a related financial institution that is exempt from tax under Part I.3 by reason of subsection 181.1(3).

This subsection is also amended by deleting the rules which treated deposit insurance corporations as being related to their member institutions. Since a deposit insurance corporation, under other amendments to Part I.3, is neither a financial institution nor subject to tax under the Part, no investment allowance is available to its member institutions irrespective of their relationship with the corporation.

Clause 149

Part I.3 - Non-Resident Corporations

ITA
181.4(d)

Section 181.4 of the Act provides the rules for determining the taxable capital employed in Canada of a non-resident corporation (other than a financial institution) for the purposes of Part I.3. New paragraph 181.4(d) is added, applicable to taxation years ending after June 1989, to provide that such a corporation may deduct, in computing its taxable capital employed in Canada, the amount representing the carrying value at the end of the year of any asset that is a ship, aircraft or related property that is operated by the corporation in international traffic and was used by the corporation in the year in connection with a business carried on through a permanent establishment in Canada. Paragraph 181.4(d) provides that this deduction is available only where the country in which the corporation is resident does not impose a capital tax on similar assets, or a tax on the income therefrom, of a corporation resident in Canada.

Clause 150

Part I.3 - Capital Deduction

ITA
181.5(7)

Section 181.5 of the Act provides corporations with a $10 million capital deduction for the purposes of the Part I.3 tax on large corporations. This deduction must be shared amongst related corporations. New subsection 181.5(7) provides that, for the purposes of allocating the capital deduction, a Canadian-controlled private corporation will be considered to be related only to those corporations with which it is also associated. This change, which was announced in a Department of Finance release dated November 30, 1990, is applicable to the 1991 and subsequent years and, where the corporation elects in writing before 1992, to its 1989 and 1990 taxation years.

Clause 151

Part I.3 - Payment of Tax

ITA
181.7(1)

Subsection 181.7(1) of the Act provides that a corporation liable to pay the Part I.3 tax on large corporations for a taxation year is required to pay the remainder of its tax payable (that is, net of any instalments paid during the year) no later than the day on which its final income tax payment under Part I of the Act is due. This amendment clarifies that a Canadian-controlled private corporation that, as a result of having no tax payable for the current year and the preceding year, claimed no deduction under subsection 125(1) in computing its Part I tax liability for either year is nonetheless permitted to pay the remainder of its tax under Part I.3 of the Act at the end of the third, rather than the second, month after its year-end. This applies where the corporation carried on an active business either in the year or in the preceding year and the aggregate of its taxable income and that of all associated corporations for the preceding year does not exceed $200,000. In order to take advantage of the one month extension a corporation must so elect in its return of income for the year.

This amendment applies to taxation years ending after June 1989, with a special transitional rule for taxation years ending before 1991.

Clause 152

Elections under Part III

ITA
184

Under subsection 83(2) of the Act, a corporation may elect to have a dividend payable by it treated as a capital dividend paid out of its capital dividend account. Similarly, a mortgage investment corporation or a mutual fund corporation may elect to pay capital gains dividends from its capital gains dividend account pursuant to subsection 130.1(4) or 131(1), respectively. Where the dividend exceeds the amount of the corporation's capital, or capital gains, dividend account at that time, subsection 184(2) of the Act requires the corporation to pay a special tax (the Part III tax) equal to 3/4 of such excess unless the corporation has elected under subsection 184(3) to treat the excess as a separate taxable dividend. This election may be made only with the concurrence of all the shareholders who received or were entitled to receive the dividend and whose addresses were known to the corporation.

The amendment to subsection 184(4) provides that, in addition to this requirement, an election made under subsection 184(3) will be valid only where it is made within 30 months of the day on which the dividend became payable or where all of the shareholders concur in the election. Subsection 184(4) further provides that where all of the shareholders have concurred with the election, the Minister of National Revenue will be empowered to make any assessment or reassessment of those shareholders' tax, interest and penalties for any year as is required to recognize the recharacterization of the distribution as a taxable dividend without regard to the limitation period relating to assessment.

This amendment, which applies to elections made under subsection 184(3) of the Act after July 13, 1990, also removes the reference in subsection 184(4) to elections made under subsection 184(3.1), which applied in respect of "qualifying dividends" payable after March 31, 1977 and before 1979 under subsection 83(1) of the Act, and to elections made under 184(3.2), which applied in respect of capital dividends paid after December 3, 1985 and before 1986.

Clause 153

Liability for Part III Tax

ITA
185

Where a corporation elects to have a dividend that is payable by it treated as a capital dividend or capital gains dividend and the amount of the dividend exceeds its capital dividend or capital gains dividend account at that time, the corporation is liable to pay a special tax, under Part III of the Act, equal to 3/4 of the excess. Section 185 contains the rules for the assessment and payment of tax and interest payable under Part III of the Act.

Section 185 is amended by adding new subsections 185(4), (5) and (6). New subsection 185(4) provides that every person who receives a dividend in respect of which a corporation has made an election under subsection 83(2), 130.1(4) or 131(1) of the Act is jointly and severally liable with the corporation for the amount of tax that, based on the total amount of the dividend to which the election applies, was payable under Part III in respect of the dividend received by that person. New subsection 185(5) provides that certain provisions of Part I of the Act relating to assessments and appeals are applicable to amounts payable by reason of new subsection 185(4). Finally, new subsection 185(6) provides that where a corporation and another person have become jointly and severally liable for an amount payable under Part III, a payment by the other person will, to the extent of the payment, serve to discharge his joint liability. A payment by the corporation, however, will discharge the other person's liability only to the extent of that proportion of the payment, in excess of any other liability of the corporation under the Act, that the amount of the dividend received by the other person is of the total amount of the dividend.

New subsections 185(4) to (6) of the Act apply to dividends paid after July 13, 1990.

Clause 154

Excepted Dividends

ITA
187.1

Paragraph (a) of the definition "excepted dividend" in section 187.1 of the Act deals with the treatment of dividends received on shares of a foreign affiliate for the purposes of the Part IV.1 tax on dividends on certain preferred shares received by corporations. The amendment to this paragraph, which applies to dividends received after 1987, provides that dividends paid on a share of a foreign affiliate will not be subject to tax under Part IV.1 except where they are received by a specified financial institution on shares acquired in the ordinary course of business.

Clause 155

Part V - Charities

ITA
188(1)(b)

Section 188 of the Act imposes a tax on charities whose registration has been revoked by the Minister of National Revenue. This amendment, which applies to the 1988 and subsequent taxation years, corrects the reference to the provisions which require official receipts in respect of charitable donations made by individuals and corporations.

Clause 156

Capital Tax on Financial Institutions - Definitions

ITA
190

Section 190 of the Act defines certain terms which apply for the purposes of the Part VI tax on the capital of financial institutions. The definition "financial institution" in subsection 190(1) is being amended to extend the application of the tax under Part VI of the Act to life insurance corporations and, in order to accommodate certain corporate structures required by the regulators of some institutions, holding corporations all or substantially all of whose assets consist of shares or debt of related financial institutions.

The amendment to subsection 190(1.1) of the Act provides that the meaning of the terms "attributed surplus", "Canadian reserve liabilities" and "total reserve liabilities" may be prescribed under the Regulations. These terms are relevant in determining the capital tax liability of life insurance corporations. It is intended that the meaning accorded to these terms for the purposes of Part I.3 of the Act be used for the purposes of Part VI.

The amendments to section 190 of the Act apply to taxation years ending after February 20, 1990.

Clause 157

Part VI - Tax Payable

ITA
190.1

Section 190.1 of the Act establishes the rate of capital tax payable by a financial institution under Part VI. The special transitional rule introduced in this clause provides that the liability of life insurance corporations and certain holding companies under Part VI is, for taxation years commencing before February 21, 1990, to be pro-rated on the basis of the portion of their year that falls after February 20, 1990.

Clause 158

Part VI - Taxable Capital Employed in Canada

ITA
190.11

Section 190.11 of the Act determines a financial institution's taxable capital employed in Canada for the purposes of the Part VI tax on financial institutions. The amendments to this section, which apply to taxation years ending after February 20, 1990, maintain the current rules in the Act applying to financial institutions that are not life insurance corporations, and provide that the taxable capital employed in Canada of a life insurance corporation resident in Canada is the total of: (a) the portion of its taxable capital that, based on the ratio of its Canadian reserve liabilities to its total reserve liabilities, is attributable to its Canadian operations; and (b) the amount by which its reserves relating to its Canadian operations exceeds (i) any portion thereof that was deductible (in the case of reserves described in subparagraph 138(3)(a)(i) of the Act) or deducted (in the case of other reserves) in computing its income for the year, and (ii) any amount outstanding in respect of a policy loan made by the corporation, to the extent that the amount was deducted in determining its deduction under clause 190.11(b)(ii)(C) in respect of its reserves described in subparagraph 138(3)(a)(i).

Clause 159

Part VI Tax - Determination of Capital and Investment Allowance

ITA
190.13 and 190.14

Section 190.13 of the Act applies for the purposes of determining a financial institution's capital for a taxation year for the purposes of the Part VI tax. The amendments to this section, which apply to taxation years ending after February 20, 1990, maintain the current rules in the Act applying to financial institutions that are not life insurance corporations, and provide that the taxable capital of a life insurance corporation resident in Canada is the amount by which its long-term debt (as defined in subsection 190(1) of the Act), share capital, retained earnings and surpluses exceeds the amount of any deferred tax debit balance or deficit in its shareholders' equity.

The capital of a non-resident life insurance corporation for a taxation year is the total of (a) the greater of its surplus funds derived from operations (as defined in paragraph 138(12)(o) of the Act) and its attributed surplus, (b) any other surpluses and any long-term debt that relate to its Canadian insurance businesses, and (c) the amount by which its reserves relating to its Canadian operations exceeds (i) the portion of those reserves that either was deductible under subparagraph 138(3)(a)(i) of the Act or was otherwise deducted, in computing its income for the year, and (ii) any amount outstanding in respect of a policy loan made by the corporation (to the extent that the amount was deducted in determining its deduction under clause 190.13(c)(iv)(C) in respect of its reserves described in subparagraph 138(3)(a)(i)).

Section 190.14 of the Act applies for the purposes of determining, under Part VI, the amount of a corporation's investments in related financial institutions. This amount is deductible from the corporation's capital, as determined under section 190.13, in computing its taxable capital under section 190.12. The amendments to section 190.14, which apply to taxation years ending after February 20, 1990, extend the current rules in the Act to all financial institutions, including life insurance corporations and certain holding corporations described in the definition "financial institution" in subsection 190(1), that are resident in Canada. Under paragraph 190.14(b), the investment allowance of a non-resident life insurance corporation is limited to shares and long-term debt of related financial institutions that are used in or held in the course of carrying on the corporation's Canadian insurance business, and to surplus of such related institutions that was contributed by the corporation.

Clause 160

Part VI - Capital Deduction

ITA
190.15

Part VI of the Act levies a tax on the capital of financial institutions. In calculating the base to which this tax applies, a financial institution is entitled to a capital deduction of up to $200 million or, where it is a member of a related group of financial institutions, such amount that, in combination with the capital deduction of other members of the group, does not exceed $200 million.

Subsections 190.15(1), (2) and (3) of the Act are amended, for the 1990 and subsequent taxation years, to provide that a financial institution's capital deduction is to be determined by reference to its "taxable capital employed in Canada" rather than its "taxable capital". The amendments also delete, in paragraph (b) of each of those subsections, the requirement to calculate a financial institution's taxable capital employed in Canada as though its capital deduction were nil; a corporation's taxable capital employed in Canada is not affected by its capital deduction and, accordingly, no adjustment in respect of this deduction is required for the purposes of section 190.15.

Clause 161

Part VI - Instalments and Final Payments

ITA
190.21 to 190.23

Section 190.21 of the Act requires corporations liable to tax under Part VI to make monthly instalments based on either their current year's estimate of Part VI tax, their preceding year's Part VI tax liability, or a combination of their preceding and second-preceding year's Part VI tax liability. Any remainder of tax payable is required to be paid within two months of the end of the year.

As a result of amendments to the definition "financial institution" in subsection 190(1) of the Act, liability for tax under Part VI is being extended to life insurance corporations and certain holding corporations. This transitional rule provides that such corporations will, for taxation years ending after February 20, 1990 but before July 1990, not be required to pay any instalments of their tax for the year and will be obligated to pay that tax only before the later of July 31, 1990 and the end of the second month after the end of the year.

For a taxation year commencing before July 1990 but ending after June 1990, an instalment will be required by the end of July 1990 based either on the corporation's estimated Part VI tax liability for the portion of the year that is after February 20, 1990 and before July 1990, or on a pro-rated amount of the corporation's notional Part VI tax liability for the preceding year (see below). For each month in the year ending after June 1990, the corporation will be obligated to make an instalment payment equal to either: its current year's estimate, less its first instalment payment required by the end of July 1990, divided by the number of such months; or its preceding year's tax liability divided by the total number of months in the year. Any remaining tax payable by the corporation will be required to be paid by the end of the second month following the end of the year.

Subsection 190.23(3) of the Act provides that, for the purposes of computing a corporation's liability for interest in respect of late or deficient Part VI instalments, the corporation will be considered to have been liable to make instalments based on either its actual (as opposed to estimated) tax payable under Part VI for the year, its tax payable for the preceding year, or its tax payable for the two preceding years. The transitional rule applying in this regard is intended to ensure that the appropriate references in subsection 190.23(3) to section 190.21 are maintained in relation to life insurance corporations and financial institution holding corporations for taxation years commencing before July 1990.

Section 190.22 of the Act defines a corporation's first and second instalment base, which are relevant in determining its obligation to make monthly instalments of tax payable under Part VI. The transitional rule relating to section 190.22 provides that life insurance corporations and financial institution holding corporations will, for the purpose of calculating their Part VI instalments on the basis of a preceding year's tax liability, be considered to have been liable to tax under Part VI for that preceding year equal to the tax that would have been payable: where the year ended before February 21, 1990, if Part VI had applied to the corporation for that year and it had claimed a capital deduction under section 190.15 of the Act equal to that claimed for its first year ending after February 20, 1990; and, where the year ended after February 20, 1990, if Part VI had applied to the full year.

Clause 162

Private Holding Corporation

ITA
191(1)

Subsection 191(1) of the Act defines certain expressions used in Part VI.1 of the Act relating to the tax on corporations paying dividends on taxable preferred shares. The definition "private holding corporation" defines certain corporations which may pay dividends on taxable preferred shares that are not subject to the Part VI.1 tax.

The amendment to paragraph (b) of this definition, which applies to the 1988 and subsequent taxation years, corrects a circularity problem that existed in determining the corporations to which this definition is intended to apply.

Clause 163

Transfers of Part VI.1 Tax Liability

ITA
191.3(2)(e)

Section 191.3 of the Act relating to the special Part VI.1 tax on corporations paying dividends on taxable preferred shares allows a corporation to transfer its liability for this tax to a related corporation. Such a transfer will enable the transferee corporation to obtain the offset as provided under paragraph 110(1)(k) against its Part I corporate tax liability.

Subsection 191.3(2) of the Act sets out certain conditions which must be met before an agreement to transfer a corporation's Part VI.1 tax liability to a related corporation will be considered to be valid. This subsection is amended, applicable to the 1989 and subsequent taxation years, to eliminate the requirement that a transferring corporation have no Part I tax liability for the year.

Clause 164

Registered Labour-Sponsored Venture Capital Corporations

ITA

Part X.3

Section 127.4 of the Act provides a tax credit to individuals in respect of their investment in the shares of prescribed labour-sponsored venture capital corporations (LSVCC's). Prescribed LSVCC's are intended to include those national LSVCC's registered under new Part X.3 of the Act which governs the activities of such corporations. Labour-sponsored venture capital corporations established under provincial legislation will also continue to be prescribed in the Regulations. New Part X.3 applies after 1988.

ITA
204.8

New section 204.8 of the Act defines various terms for the purposes of new Part X.3.

"Annuitant" is defined as having the meaning assigned by subsection 146(1), namely, the individual in respect of whom retirement income will commence upon the maturity of a contract or arrangement held in a registered retirement savings plan (RRSP), and, after the death of the individual, the individual's spouse, who may be entitled to receive benefits paid out of or in respect of the contract or arrangement.

"Eligible business entity" is defined as a Canadian partnership or taxable Canadian corporation, where all or substantially all of the fair market value of the property of the partnership or corporation is property used in an active business carried on in Canada by the entity or corporation controlled by the entity or shares or debt of an eligible business entity related to the particular entity. After a start-up period of 5 years, a national labour-sponsored venture capital corporation (NLSVCC) is required to invest 60% of its shareholders' equity in equity or unsecured debt of eligible business entities.

"Eligible investment" of a NLSVCC is defined as:

- a share of a corporation that was an eligible business entity at the time the share was issued to the NLSVCC. The share must have the characteristics of shares that are prescribed shares for the purposes (and thus excluded from the scope) of subsections 110.6(8) and (9) of the Act. These subsections deny the lifetime capital gains exemption where it may reasonably be considered that a significant portion of the taxable capital gain from the disposition of a share is attributed to the fact that dividends were not paid on the share;

- a debt obligation of a corporation or partnership that was an eligible business entity at the time the debt was issued to the NLSVCC. The debt obligation must not restrict the issuing entity from incurring other debts, may be secured solely by a floating charge on the assets of the entity or by a guarantee of the NLSVCC and, in general, must be subordinate to all other debt obligations issued by the entity. An exception to this last requirement is permitted, where the entity is a corporation, with respect to debt obligations issued by the corporation that are small business securities, prescribed for purposes of paragraph (a) of the definition of "small business property" in subsection 206(1) of the Act or a debt obligation issued by the entity to one of its shareholders or a person related to one of its shareholders.

- a guarantee provided by the NLSVCC of a debt obligation that would be described above if it had been issued to the NLSVCC at the time the guarantee was provided, and

- an option or right granted by the entity, together with the issue of a share or debt obligation that is an eligible investment, to acquire a share of the capital stock of the entity.

Immediately after the issue of the eligible investment, as described above, the following conditions must also be met:

- the cost to the NLSVCC of all shares, debt obligations, options, rights and 25% of the amount of all guarantees, in respect of the eligible business entity and all corporations related thereto, does not exceed the lesser of $10 million and 10% of the shareholders' equity in the NLSVCC,

- the carrying value of total assets of the eligible business entity and all corporations related thereto does not exceed $35 million, and

- the number of employees of the eligible business entity and all corporations related thereto does not exceed 500.

"Labour-sponsored funds tax credit" is defined as having the same meaning as that provided for in subsection 127.4(1) of the Act.

"National central labour body" is defined as an organization comprised of at least two trade unions as defined in the Canada Labour Code. Each trade union for this purpose must represent employees in at least two provinces.

"Original purchaser" of a share is defined as the individual to whom the share was issued.

"Registered labour-sponsored venture capital corporation" is defined as a corporation registered under the provisions of new subsection 204.81(1) of the Act.

"Reserve" is defined as property of the following descriptions:

- cash (including certain funds on deposit),

- bonds, debentures, notes, mortgages or similar obligations of or guaranteed by the government of Canada, of a province or municipality, of a crown corporation or, if guaranteed by the government of a province, of an educational institution or hospital,

- bonds, debentures, notes, mortgages or similar obligations of a corporation whose shares are listed on a prescribed stock exchange in Canada,

- guaranteed investment certificates issued by a trust company incorporated federally or provincially, and

- investment contracts issued by a corporation approved by the Governor in Council for purposes of section 146 relating to registered retirement savings plans.

"Revoked corporation" is defined as a labour-sponsored venture capital corporation the registration of which has been revoked under the provisions of subsection 204.81(6).

"Specified active business" is defined as an active business carried on in Canada where at least 50% of the full-time employees of the business are employed in Canada and at least 50% of the wages and salaries paid to employees of the active business are attributable to services rendered in Canada by employees.

ITA
204.81(1)

New subsection 204.81(1) permits the Minister of National Revenue to register a corporation as a labour-sponsored venture capital corporation if the corporation applies in prescribed form, the corporation itself was incorporated under the Canada Business Corporations Act by a national central labour body and the articles of incorporation of the corporation contain various conditions mandated by new paragraph 204.81(1)(c). These conditions, which govern the operation and investment activities of the corporation and the type of shares which the corporation may issue, are as follows:

- The business of a registered labour-sponsored venture capital corporation (RLSVCC) is restricted to assisting the development of small and medium-sized businesses, and to creating, maintaining and protecting jobs by providing financial and managerial advice to such businesses and by investing funds of the corporation in accordance with the requirements of section 204.81.

- The authorized capital of an RLSVCC is restricted to certain types of shares. Class A shares of an RLSVCC may be issued only to individuals. These shares entitle the original purchaser to the labour-sponsored funds tax credit under section 127.4 of the Act and are redeemable and transferable by the original purchaser only in certain limited circumstances. The RLSVCC may issue Class B shares to the national central labour body which caused it to be incorporated. These shares do not entitle the national central labour body to receive dividends. Other classes of shares may be issued where the rights and conditions attaching thereto have been approved by the Minister of Finance.

- Not less than one-half of the directors of an RLSVCC must be appointed by the national central labour body which caused the RLSVCC to be incorporated.

- An RLSVCC may not reduce its paid-up capital in respect of any shares, other than Class B shares, otherwise than by the redemption of such shares, or in such other manner as may be prescribed. At the current time, no other methods are contemplated to be so prescribed.

- A Class A share of an RLSVCC in respect of which an information return has been issued may be redeemed by the corporation only where the corporation is requested to do so in writing by the holder of the share. The corporation may only comply with the request where:

    - the share is held by the original purchaser, and

        - the request to redeem the share is made within 60 days of the date on which the share was issued, the information return issued in respect of the share has been returned to the corporation, and the share is not held as an investment in a registered retirement savings plan,

        - the corporation is notified in writing that the original purchaser has, after acquiring the share, become disabled and permanently unfit for work or become terminally ill, or

        - where the share has been issued and outstanding two years or more, the corporation is notified in writing that the original purchaser has retired from the workforce, has attained 65 years of age or has ceased to be resident in Canada,

    - where the original purchaser has died, the time of redemption is on or after the day on which the original purchaser would have attained 65 years of age,

    - where the original purchaser is alive and the share has been issued and outstanding two years or more and is held by a person other than the original purchaser, the time of redemption is on or after the day on which the original purchaser attained 65 years of age,

- the share is held by an individual who received it upon the death of a shareholder of the corporation,

- the share is held in a registered retirement savings plan under which the original purchaser or the original purchaser's spouse is the annuitant and the original purchaser has died, or where the corporation is notified in writing

  - where the share has been issued and outstanding two years or more, that the original purchaser has retired from the workforce, attained 65 years of age or ceased to reside in Canada, or

  - that the original purchaser has, after acquiring the share, become disabled and permanently unfit for work, or become terminally ill,

- the share is held in a registered retirement savings plan under which the annuitant is a person other than the original purchaser or the original purchaser's spouse, and the time of redemption

  - is on or after the date on which the original purchaser attained, or would have attained, 65 years of age, and

  - where the original purchaser is alive, occurs after the share has been issued and outstanding two years,

- the redemption occurs more than 8 years after the share was issued, or

- the holder of the share has satisfied such other conditions as may be prescribed by regulation. At the present time no other conditions are contemplated to be prescribed.

- An RLSVCC is prohibited from registering a transfer of a Class A share by the original purchaser, or by a registered retirement savings plan under which the original purchaser or the original purchaser's spouse is the annuitant unless the transfer takes place more than 5 years after the date on which the share was issued, or the corporation is notified in writing that the share is being transferred

  - to be held as an investment of a registered retirement savings plan where the annuitant is the original purchaser or the original purchaser's spouse,

  - as a result of the death of the original purchaser,

  - at a time when the original purchaser

- has retired from the workforce, or has reached 65 years of age,

- has, after acquiring the share, become disabled and permanently unfit for work, or become terminally ill, or

- has ceased to be a resident of Canada, or

- in accordance with such other conditions as may be prescribed. At the present time, no other conditions are contemplated to be prescribed.

- The articles of incorporation of an RLSVCC must provide that no fee or remuneration may be paid by the corporation to any shareholder, director or officer of the corporation unless the payment has first been approved by resolution of the directors of the corporation.

- An RLSVCC is prohibited from investing in an eligible business entity with which it, or any of its directors, does not deal at arm's length, except where the non-arm's length relationship is brought about solely as a result of the corporation's eligible investments in the entity or the investment was approved by a special resolution of the shareholders of the corporation before the investment was made.

ITA
204.81(2) and (3)

New subsection 204.81(2) of the Act provides that, upon registering a corporation as an RLSVCC, the Minister of National Revenue will assign a registration number to it.

New subsection 204.81(3) of the Act governs the situation in which a national central labour body has caused more than one national LSVCC to be registered and ensures that the five-year "start-up period" in which an RLSVCC need not meet the 60% investment requirements in eligible businesses cannot be extended by creating a succession of national LSVCC's. For the purposes of paragraph 204.81(6)(h) (the investment requirements for the first 5 years of an RLSVCC) and section 204.82 (the section which imposes a tax and penalty for failure of the RLSVCC to meet various investment requirements specified therein), each of the corporations incorporated by the same national central labour body shall be deemed to have issued a Class A share at the earliest time any such corporation issued a Class A share. For these purposes each corporation registered by the same national central labour body is deemed to have been in existence for the period commencing immediately before the first such Class A share was issued and ending immediately after the corporation was incorporated. During this deemed period of existence, each corporation is deemed to have had fiscal periods ending on the same day in the calendar year on which its first actual fiscal period after it was incorporated ended.

ITA
204.81(4)

New subsection 204.81(4) of the Act provides that, for the purposes of new Part X.3, the cost at any time to a corporation of a guarantee that is an eligible investment is treated as being 25% of the amount of the debt obligation subject to the guarantee at that time.

ITA
204.81(5) and (6)

New subsection 204.81(5) of the Act provides for the date of registration of a labour-sponsored venture capital corporation. Where the Minister of National Revenue has registered a corporation for the purposes of new Part X.3, the corporation is considered to have been registered on the date the application for registration was received by the Department of National Revenue or such later date as may be specified in the application.

New subsection 204.81(6) of the Act permits the Department of National Revenue to revoke the registration of a labour-sponsored venture capital corporation in the following situations:

- the corporation fails to comply with any of the provisions of its articles of incorporation as outlined above,

- the corporation fails to file with the Department of National Revenue by March 31 of a year, an information return in prescribed form, generally containing a summary of the consideration received upon the sale of shares of the corporation and a list of the shareholders to which the shares were sold in the one year period ending on the 60th day of that year,

- the corporation fails to issue on a timely basis the information return required to be provided to an individual who has purchased shares eligible for the labour-sponsored funds tax credit or irrevocably subscribed and paid for such shares. Where such purchase or subscription occurs in the period commencing on the 61st day of a calendar year and ending on the 60th day of the immediately following year, the corporation is required to issue the information return to the individual on or before March 31 of that immediately following calendar year. The information return must state the consideration paid by the individual for the shares. It is this information return which, when filed with the individual's return of income for the year, will entitle the individual to the federal labour-sponsored funds tax credit under section 127.4 of the Act,

- the corporation issues more than one information return in respect of any particular Class A share,

- the corporation's financial statements have not been prepared in accordance with generally accepted accounting principles,

- the corporation fails to effect an independent valuation of its shares as at the end of a taxation year within 6 months after the end of that year,

- at any time in any of its first 5 taxation years, after which the corporation first issues a Class A share, the corporation fails to invest in eligible investments or reserves the required percentage of the consideration received by it upon the sale of Class A shares. At any particular time in the 5 year period, the amount to be maintained in eligible investments or reserves is 80% of the excess of the consideration received by the corporation for Class A shares issued before that time over amounts paid before that time to shareholders as a return of capital,

- the corporation has not paid the tax or penalty payable under section 204.82 by the due date,

- the corporation has incurred the tax described in subsection 204.82(3) for three or more taxation years (See the commentary to those provisions for further details as to their application),

- the corporation fails to maintain a reserve equal to the cost of any guarantee which it has provided that is an eligible investment. As noted above, subsection 204.81(2) treats the cost at any time of a guarantee of a debt obligation as being 25% of the amount of the debt obligation subject to the guarantee at that time,

- the corporation has paid an unreasonably large fee or commission in respect of the sale of its shares, or

- the corporation has failed to meet the 60% investment requirement mandated by new subsection 204.82(2) in eligible business entities in 18 or more months in any 36 month period.

ITA
204.81(7) to (9)

New subsection 204.81(7) of the Act provides that, if the Minister of National Revenue proposes to revoke the registration of the corporation pursuant to subsection 204.81(6), the Minister shall notify the corporation by registered mail.

New subsection 204.81(8) of the Act provides that, if the Minister of National Revenue gives notice of his intent to revoke a corporation's registration under new subsection 204.81(7), he may, within 30 days publish a copy of the notice in the Canada Gazette. The revocation of registration is effective on such publication in the Canada Gazette. Provision is also made for publication in the Gazette to be delayed until after the expiry of any extended period from the date of mailing of the notice as may be allowed by the Federal Court of Appeal upon application thereto made at any time before the determination of an appeal of the revocation under subsection 204.81(9).

New subsection 204.81(9) of the Act provides a right of appeal to the Federal Court of Appeal from a decision of the Minister not to register a corporation or to revoke the registration of a corporation under new Part X.3.

ITA
204.82

New section 204.82 of the Act, which imposes various taxes and penalties, applies in circumstances where an RLSVCC fails to meet the investment requirements provided for in new subsections 204.82(1) and (2).

New subsection 204.82(1) of the Act levies a tax on an RLSVCC where, at any time in any of its first five taxation years after it first issued a Class A share, the corporation fails to invest at least 80% of the consideration received by it for the sale of Class A shares before that time (net of amounts paid by the corporation to its shareholders before that time as a return of capital on such shares) in eligible investments and reserves. The tax is calculated as 20% of the shortfall, less any taxes payable under this subsection by the corporation for previous years.

New subsection 204.82(2) of the Act imposes a tax on an RLSVCC where, at any time after the first five taxation years of the corporation referred to in subsection 204.82(1), it fails to achieve the required level of eligible investments in eligible business entities. This level is determined as 60% of the lesser of the amount of the shareholders' equity of the corporation as at the end of the preceding taxation year (determined without taking into account any unrealized gains or losses in eligible investments of the corporation) and the amount of the shareholders' equity of the corporation determined at the end of the taxation year (determined without taking into account any unrealized gains or losses on eligible investments of the corporation). Where at any time in a month the total cost of the corporation's eligible investments falls short of the required investment level, the corporation is required to pay a tax in respect of the shortfall equal to the greatest such shortfall in the month multiplied by 1/60th of the prescribed rate of interest in effect for the month. This tax is payable in respect of each month in which such a shortfall occurs.

New subsection 204.82(3) of the Act provides an additional tax where an RLSVCC is required to pay the tax described in subsection 204.82(2) in respect of 12 consecutive months. This additional tax is calculated as 20% of the average investment shortfall for those 12 months, from which amount is subtracted the total of all taxes paid or payable under this subsection or subsection 204.82(1) by the corporation in respect of preceding taxation years (net of all amounts previously refunded by reason of section 204.83 to the corporation in respect of the tax payable under this subsection).

Where a corporation is liable to pay a tax under subsection 204.82(3), new subsection 204.82(4) imposes a penalty on the corporation, in addition to the tax, of an amount equivalent to the tax.

ITA
204.83

New section 204.83 of the Act requires the Minister of National Revenue to refund to an RLSVCC 100% of the tax payable under new subsection 204.82(3) and 80% of the penalty payable under new subsection 204.82(4) where, throughout any 12-month period commencing subsequent to the 12-month period in respect of which the tax became payable, the corporation has maintained the required level of eligible investments.

ITA
204.84

New section 204.84 imposes a penalty on an RLSVCC that has issued an information return in respect of the issue of a Class A share at a time when the registration of the corporation is revoked or in respect of a subscription for a Class A share by an individual where the share is not issued within 180 days from the date the information return is issued. This penalty is equivalent to the amount of consideration received by the corporation for the sale of the share.

ITA
204.85 to 204.87

New section 204.85 of the Act provides that an RLSVCC may not liquidate or dissolve without the written permission of the Minister of Finance, if the corporation has issued any Class A shares. The Minister of Finance also has the authority to impose terms and conditions upon the dissolution of the corporation.

New section 204.86 of the Act provides that every RLSVCC and every revoked corporation must file a return under new Part X.3. The corporation must estimate in the Part X.3 return the amount of tax and penalties payable, if any, under Part X.3. Where a tax or penalty is owing under this Part, the corporation is required to pay the tax and penalty within 90 days after the end of the taxation year in respect of which the liability arose.

New section 204.87 of the Act incorporates various sections dealing with the administration of Part I of the Act into the structure of new Part X.3, with such modifications to their operation as may be required in the circumstances being addressed by Part X.3.

Clause 165

Tax on Overpayments to
Registered Education Savings Plans

ITA

Part X.4

New Part X.4 of the Act provides for a special tax to be paid by individuals with respect to overpayments made to registered education savings plans. The purpose of this tax is to limit the amount of tax-deferred income that may be accumulated for any one beneficiary, by limiting the annual and aggregate amounts of payments that may be made into registered education savings plans for a particular beneficiary.

ITA
204.9 to 204.93

New subsection 204.9(1) of the Act defines certain expressions used in new Part X.4.

An "excess amount" for a year is the total amount on which tax under Part X.4 is payable. An excess amount for a year will occur when the total of all payments into registered education savings plans for a particular beneficiary, made by one or more individuals, either exceeds the annual limit of $1,500 in any year, or causes the total of all payments made for that beneficiary to exceed the lifetime limit of $31,500. Payments made before February 21, 1990 are excluded from the annual limit for that year, but are included in the lifetime limit. Where the total of all payments made before February 21, 1990 for a particular beneficiary exceeds the lifetime limit of $31,500, no excess amount will result unless further payments are made to a registered education savings plan for that beneficiary after that date.

The definition of a subscriber's share of the excess amount provides that where an excess amount for a year occurs, each subscriber will assume a pro-rata share of the excess, based on his or her payments for that beneficiary, for purposes of determining his or her liability for tax under this Part.

New subsection 204.9(2) of the Act provides some relief from Part X.4 tax to individuals who have entered into agreements before February 21, 1990 which require them to make payments to registered education savings plans in excess of the limits described in this Part, where at least one such payment has been made before February 21, 1990. Where the total of such payments made in a year in respect of a beneficiary would otherwise result in an excess amount for the year, this subsection deems that excess amount not to exceed the amount that would be determined in accordance with subsection 204.9(1) for the year if the total of such payments were equal to the contribution room available in respect of the particular beneficiary for the year. As a result, such payments will not by themselves give rise to an excess contribution, although they will be taken into account in determining the contribution room available in respect of the beneficiary for other payments to which the subsection does not apply. For these purposes, where the agreement permits the subscriber to pay a lump sum amount in satisfaction of the requirement to make periodic payments, such lump sum payment will be treated in the same way as the required payments under the agreement.

New subsection 204.9(3) of the Act is intended to allow those individuals who entered into education savings plans before February 21, 1990, with promoters who were in the process of registering their plans at that date, to pay any refund of payments (plus interest) that may be received from the promoters into registered education savings plans without regard to the new limits contained in this Part.

New subsection 204.9(4) of the Act provides that where the named beneficiary under a plan is changed, the contributions which were previously made into the plan for the former beneficiary are considered to have been made for the new beneficiary. This is intended to ensure that the contribution limits may not be multiplied by having a number of plans for different named beneficiaries and changing the named beneficiary just prior to terminating the plans.

New section 204.91 of the Act provides that a tax of 1% per month will be payable by an individual on his or her share of any excess amount that exists in respect of a particular beneficiary, as defined in section 204.9. An individual may avoid this tax by having his or her share of the excess withdrawn before the end of the month in which the excess amount arose.

New section 204.92 of the Act provides that an individual is to file a return, estimating the tax payable by him or her under this Part, and pay the applicable tax within 90 days after the end of the year. As provided in the coming-into-force provision for this section, no return or payment will be required to be filed or made until 90 days after Royal Assent is given to this legislation. New section 204.93 provides that the provisions of Part I of the Act dealing with the filing of returns, assessments and reassessments, interest, penalties and appeals apply to this Part with the required modifications.

This Part is applicable to months ending after January, 1990.

Clause 166

Part XI Tax on Foreign Property

ITA
206

Section 206 of the Act imposes a tax on the amount of "foreign property" (as defined in subsection 206(1)) held by pension funds and certain other tax exempt entities in excess of defined limits.

Subclause 166(1)

ITA
206(1)

"foreign property"

Paragraph (g) of the definition "foreign property" in subsection 206(1) of the Act is amended by adding the International Finance Corporation to the list of non-resident organizations, the bonds, debentures, mortgages, hypothecs, notes or similar obligations of which are exempted from the definition "foreign property".

This amendment is applicable after July 13, 1990.

Subclauses 166(2) and (3)

ITA
206(2)(b) and (c)

Under the existing law tax is payable under Part XI of the Act where, at the end of any month, the tax cost of foreign property held by a pension or other deferred income plan exceeds 10% of the tax cost of all its assets. The amount of this tax is determined under subsection 206(2).

Paragraph 206(2)(b) of the Act is amended to provide that the maximum percentage of foreign property that may be held by such entities without incurring that tax is increased to 12%, 14%, 16% and 18% for 1990, 1991, 1992 and 1993, respectively, and to 20% for subsequent years. It is intended that corresponding changes will be made to Part L (section 5000) of the Regulations.

The limit on the cost amount of foreign property holdings may be increased where the taxpayer also holds certain small business investments. This additional amount, which is determined under paragraph 206(2)(c), is limited to 2 times the 10% limit. Subparagraph 206(2)(c)(ii) is amended to substitute a reference to 20%, applicable to the 1990 and subsequent years.

Clause 167

Deferred Income Plans - Share Acquisition Agreements

ITA
206.1

Section 206.1 of the Act provides that where a pension fund or other deferred income plan enters into an agreement (otherwise by reason of its writing or acquisition of an option listed on a prescribed stock exchange) to purchase shares at a price that may differ from their fair market value at the time that the purchase is to take place, it will be required to pay a penalty tax equal to 1% of the stipulated purchase price of the shares for each month that the agreement is outstanding. Section 206.1 is intended to prevent tax-exempt entities from temporarily transferring shares to persons, particularly corporations, that are able to receive dividends on those shares on a tax-favoured basis.

Section 206.1 is amended to provide that the 1% penalty tax will be calculated on the basis of the fair market value of the shares transferred rather than their stipulated purchase price. This amendment, which applies to agreements entered into after July 13, 1990, is intended to prevent these taxpayers from effectively avoiding liability under this section by electing to transfer the shares at a nominal acquisition price.

Clause 168

Part XI.2

ITA
207.3

Section 207.3 of the Act imposes a tax in certain circumstances on institutions or public authorities that dispose of certified cultural property. Section 207.3 currently refers to subsection 26(2) of the Cultural Property Export and Import Act and is being amended, applicable with respect to dispositions made after December 11, 1988, strictly as a consequence of the re-numbering of that Act.

Clause 169

Tax Payable by Exempt Persons

ITA
208

Section 208 of the Act imposes a penalty tax on tax-exempt persons in respect of certain royalties and related payments paid to the Crown by the tax-exempt person. The purpose of the tax is to discourage transactions between tax-exempt persons and taxable persons designed to shift the tax burden of Crown royalties from a taxable to a tax-exempt person, thereby resulting in a tax advantage since the tax-exempt person would not be affected by the treatment of Crown royalties under paragraphs 12(1)(o) and 18(1)(m).

Section 208 is amended to exclude from the application of the penalty tax those arrangements in which all amounts payable in respect of resource production by a tax-exempt person thereunder were paid to another tax-exempt person, unless such payments were made as part of a transaction or event (or series of transactions or events) to which a taxable entity was a party. This amendment narrows the scope of section 208 to target the abuse at which the provision was originally aimed.

Amended subparagraph 208(1)(b)(i) is applicable to the 1988 and subsequent taxation years.

Clause 170

Tax on Carved-Out Income

ITA
209

Part XII.1 of the Act imposes a special tax on "carved-out income". In general terms, the purpose of this tax is to discourage the use of tax-exempt persons and loss corporations for the holding of profitable resource property in respect of which profitable persons retain a substantial economic interest. "Carved-out income" is computed with reference to "carved-out property", both of which are defined in section 209.

The definition of "carved-out property" in subsection 209(1) excludes in paragraph (c) thereof resource property of a taxpayer acquired pursuant to a farm-in agreement with another party (known as the "farmor") where the sole consideration given for such property by the taxpayer (know as the "farmee") was its undertaking to incur Canadian exploration expense or Canadian development expenses in respect of the property. This paragraph is amended so that the consideration given may also include an undertaking to acquire gas or oil well equipment (as defined in subsection 1104(2) of the Regulations) in respect of the property. The purpose of this amendment is to ensure that a typical farm-in arrangement, in which the farmer agrees to pay for equipping costs, is not subject to the application of Part XII.1.

The definition "carved-out property" in subsection 209(1) is also amended to ensure that property retained by a farmor, pursuant to a farm-in arrangement described above, is also not regarded as being "carved-out property".

The definition of "carved-out property" in section 209 is also amended by excluding the property of a tax-exempt person where two conditions are met. First, the property is required not to relate to property of another person whose taxable income is not exempt from tax under Part I. Second, the property is required not to be, nor to relate to, property that has been a carved-out property of any other person at any time. This amendment narrows the scope of section 209 in accordance with its original intent.

The amendments relating to farm-in agreements apply in respect of property acquired after July 19, 1985. The amendment relating to the property of tax-exempt persons applies with respect to property acquired after 1987.

Clauses 171 to 173

Part XII.3

Tax on Investment Income of Life Insurers

Part XII.3 of the Act imposes a tax on the investment income of life insurers.

Clause 171
ITA
211

Section 211 of the Act defines a number of terms for the purposes of Part XII.3 of the Act. The amendment in subclause 171(1) repeals the existing section 211 of the Act and substitutes therefor new subsections 211(1) and (2).

New subsection 211(1) defines the following terms for the purposes of Part XII.3.

"Existing guaranteed life insurance policy"

An "existing guaranteed life insurance policy" of an insurer is defined in new subsection 211(1) as a non-participating life insurance policy in Canada of the insurer, where the amount and number of premium payments and the benefits under the policy are fixed and determined on or before December 31, 1989. As provided in new subsection (2), a change in the terms or conditions of a life insurance policy resulting from a "specified transaction or event" will not affect the status of the policy as an existing guaranteed life insurance policy. An existing guaranteed life insurance policy is not a taxable life insurance policy, as described below, and consequently is excluded from the scope of Part XII.3 tax.

"Life insurance policy"

New subsection 211(1) provides that the terms "life insurance policy" and "life insurance policy in Canada" do not include any part of a policy for which the insurer's reserves vary in amount depending on the value of a segregated fund, nor do they include a reinsurance arrangement.

"Net interest rate"

New subsection 211(1) provides for the determination of a "net interest rate" in respect of each liability, benefit, risk or guarantee under a life insurance policy. This rate is used in the computation of the insurer's Canadian life investment income or loss under new subsection 211.1(3), described below.

The first component "(A - B)" in the determination of a net interest rate is the moving average for the 60 months prior to the current taxation year of the average yield on domestic Canadian-dollar Government of Canada bonds which are outstanding on the last Wednesday of the month and have a remaining term to maturity of more than 10 years (i.e., series B14013 in the monthly publication of Bank of Canada Review). Where the net interest rate is being determined in respect of a guaranteed benefit under a policy in existence on March 2, 1988, this moving average rate may be reduced by the interest rate used by the insurer in determining such guaranteed benefit under the policy or 4%, whichever is greater. This reduction is not available in respect of a policy if its terms and conditions relating to premiums or benefits have been changed, unless the changed terms were determined before March 3, 1988 or resulted from specified transactions or events (as provided in new subsection (2)).

The second component "C" is a percentage which is multiplied by the first component in determining the net interest rate. This percentage recognizes, in a general way, the expenses and profits of the insurer which relate to the gross investment revenues of the insurer. The percentage is 55%, except where the moving average rate to which the percentage applies has been reduced as described above in respect of a guaranteed benefit. In such cases, the percentage is 65%, which reflects the fact that a larger portion of investment related expenses has been previously recovered by the insurer in respect of polices in existence on March 2, 1988.

"Non-participating life insurance policy"

The definition of "non-participating life insurance policy" which is provided in new subsection 211(1) is relevant in the definition of "existing guaranteed life insurance policy", described above.

"participating life insurance policy", "policy loan" and "segregated fund"

The definitions of "participating life insurance policy", "policy loan" and "segregated fund" are provided in new subsection 211(1) by reference to the definitions of these expressions contained in subsection 138(12) of the Act.

"registered life insurance policy"

The definition of "registered life insurance policy" is provided in new subsection 211(1). A registered life insurance policy is not a taxable life insurance policy, as described below, and therefore is excluded from the scope of the Part XII.3 tax.

"reinsurance arrangement"

New subsection 211(1) provides the definition of "reinsurance arrangement" for the purposes of Part XII.3 of the Act. This definition is relevant in the definitions of "life insurance policy" and "life insurance policy in Canada", described above, and in the determination of an insurer's Canadian life investment income under new subsection 211.1(3), described below.

"specified transaction or event"

The definition of "specified transaction or event" which is provided in new subsection 211(1) is relevant to the rule provided in new subsection (2).

"taxable life insurance policy"

New subsection 211(1) provides that a "taxable life insurance policy" of an insurer is a life insurance policy in Canada (which has the meaning assigned by paragraph 138(12)(g) of the Act), either issued by the insurer or where the obligations of the issuer to the policyholder have been assumed by the insurer. A taxable life insurance policy does not include an annuity contract, a registered life insurance policy, registered pension fund or retirement compensation arrangement or an existing guaranteed life insurance policy.

Taxable life insurance policies are those polices in respect of which the tax under Part XII.3 is determined, as described below in the comments on subsection 211.1(3).

New subsection 211(2) provides two rules for the purposes of Part XII.3. The first rule provides that when a rider is added to a life insurance policy after March 2, 1988, it shall be treated as a separate policy effected at the time the rider is added to the policy. The second rule provides that a change to the terms or conditions of a policy resulting from a specified transaction or event, as defined in new subsection 211(1), shall be considered not to have occurred and not to be a change. Such a change consequently does not give rise to a change of status of the policy, either as an existing guaranteed life insurance policy or for the purposes of determining the net interest rate, where the policy was in existence on March 2, 1988.

The amendments to section 211 of the Act described above apply with respect to taxation years commencing after 1989, except that where an insurer elects to have new subsection 211.1(3) apply in respect of a prior taxation year, new subsections 211(1) and (2) will also apply in respect of such prior years. Where an insurer elects to have new subsection 211.1(3) apply in respect of a prior year, the references to December 31, 1989 in respect of a life insurance policy are to be read as references to the later of the date of issue of the policy and March 2, 1988.

In addition, subclause 171(2) amends the provisions of section 211 of the Act in its application to taxation years ending after 1987 and commencing before 1990, other than a year in respect of which the insurer has elected to have new subsection 211.1(3) apply. This amendment adds a definition of the expression "benefits payable under a life insurance policy", which is used in paragraph (b) in the description of B in subsection 211.1(3).

The amendment clarifies that such benefits include policy dividends, experience rating refunds and refunds of premiums, but do not include policy loans or interest on funds left on deposit with the insurer. In addition, the amendment ensures that amounts payable under reinsurance arrangements in respect of life insurance policies, as well as amounts transferred from an insurer's non-segregated funds in respect of life insurance policies to its segregated funds are treated as amounts in respect of benefits payable under the policies. Such amounts are not included in the description of B for the purposes of subsection 211.1(3) of the Act.

Clause 172
ITA
211.1

Section 211.1 of the Act contains the provisions which apply in determining the tax payable by a life insurer for a taxation year under Part XII.3. Subsections 211.1(2) and (3) of the Act are amended as described below.

ITA
211.1(2)

Subsection 211.1(2) of the Act is amended to limit the seven year carry forward of Canadian life investment losses to losses arising in 1990 and subsequent taxation years. This restriction is consistent with the significant changes to the design of the Part XII.3 tax.

ITA
211.1(3)

Subsection 211.1(3) of the Act provides for the determination of an insurer's Canadian life investment income or loss for a taxation year for the purposes of Part XII.3. Subsection 211.1(3) of the Act is repealed and a new provision substituted therefore. Under the new provision, the Canadian life investment income or loss of an insurer for a year is determined under the formula:

A + B - C.

The amount "A" in the formula is the aggregate for the year of amounts in respect of all life insurance policies of the insurer that are taxable life insurance policies at any time in the year. The amount is determined by multiplying the net interest rate in respect of each liability, benefit, risk or guarantee under such policies by the mean of the maximum amounts that would be deductible in computing the insurer's income for the year and for the immediately preceding year in respect of specified policy reserves, if such maximum amounts were determined without reference to any policy loan or reinsurance arrangement. The reserves specified for these purposes are those determined in accordance with paragraph 1401(1)(a), (c) or (d) of the Income Tax Regulations, other than disabled life reserves determined under subparagraph 1401(1)(d)(ii) of the Regulations.

The amount "B" in the formula, is the aggregate for the year of all amounts determined under the formula "D - E". These amounts are, as described below, in respect of group life insurance policies that are taxable life insurance polices of the insurer.

"D" is the product of the 60 month moving average interest rate for the year used in determining the first component of "net interest rate", described above, and the mean of the maximum reserve amounts in respect of the insurer for the year and for the immediately preceding year in respect of such policies under paragraph 1401(1)(c.1) of the Regulations, determined without reference to any policy loan or reinsurance arrangement.

"E" is the excess of the aggregate of amounts determined in respect of the insurer under "D" for the current and all prior taxation years ending after 1989 over any increase in the amount of the insurer's maximum reserve under paragraph 1401(1)(c.1) of the Regulations, commencing with its 1989 taxation year and ending with the current taxation year, to the extent such excess has not previously been deducted as an "E" amount. The deduction of amount "E" for a year in which it exceeds amount "D" for the year will result in a negative amount for amount "B" for the year.

The amount "C" represents a full deduction for amounts which are, by regulation, required to be reported to policyholders in respect of proceeds of disposition, policy dividends or policy loans, or amounts arising under the accrual rules, under taxable life insurance policies of the insurer, other than policies which are either partly or fully grandfathered under the provisions of Part XII.3. For such grandfathered polices, the "C" amount is determined by pro-rating the amount reported to the policyholder in accordance with the formula provided under paragraph (a), in the case of a partly grandfathered policy, or under paragraph (b), in the case of a policy that was, at any time after 1989, an existing guaranteed life insurance policy.

New subsections 211.1(2) and (3) will apply in respect of taxation years commencing after 1989, except that an insurer can elect to use these new rules for the 1989 taxation year or for both the 1988 and 1989 taxation years.

In addition, subclause 172(2) amends the description of C and G in subsection 211.1(3) of the Act, in application to taxation years ending after 1987 and commencing before 1990, other than a year in respect of which the insurer has elected to have new subsection 211.1(3) apply.

The amount determined in the description of C in subsection 211.1(3) of the Act represents the insurer's Part I income or loss, as the case may be, adjusted for specified items. The amendment to the description of C is necessary to ensure that, in respect of the insurer's first taxation year commencing after June 17, 1987 and ending after 1987, the amounts included in income under paragraph 138(4)(a) in respect of the immediately preceding year are computed under the new rules which apply in determining the insurer's reserves for the year. As a result, for the first year of the tax imposed under Part XII.3, both the opening and closing reserves of an insurer will be determined under the new rules introduced in 1988. (For example, the amount that would be allowed by regulation in respect of outstanding claims of the insurer pursuant to subparagraph 138(3)(a)(ii), if those regulations had applied in respect of the immediately preceding year, will be required to be included in the amount determined in the description of C.) In addition, this amendment will ensure that the amount of an insurer's 1968 reserve adjustment, which would otherwise reduce the amount of insurer's required inclusion under paragraph 138(4)(a) for the insurer's first 1988 taxation year commencing after June 17, 1987, is not taken into account in determining the amount in the description of C. This is appropriate since this amount relates to years prior to the introduction of Part XII.3.

The description of G excludes from the Part XII.3 tax base amounts which policyholders are required to include in income in respect of their life insurance policies. The amendment to the description of G removes an incorrect reference to subsection 12(8) of the Act.

Clause 173
ITA
211.5 and 211.6

Section 211.5 of the Act provides for interest in respect of payments of tax under Part XII.3 which are not paid in accordance with sections 211.3 and 211.4. The section is being amended to incorporate the provisions of section 211.6, which provide that certain rules contained in Part I concerning assessments, interest, penalties, refunds, objections and appeals are applicable, with such modifications as the circumstances require, Part XII.3. The amendment also adds references to subsections 157(2.1) and 161(2), (2.1), (2.2) and (11) to the rules already enumerated in section 211.6. Subsection 157(2.1) modifies the requirements in respect of instalments of tax, subsections 161(2), (2.1) and (2.2) provide for interest on amounts of tax which are not paid on or before the required time, and subsection 161(11) provides for interest on penalties payable under various provisions of the Act. As a consequence of the amendments to section 211.5, section 211.6 will be made redundant. Accordingly, the amendment repeals section 211.6.

These amendments are applicable to the 1990 and subsequent taxation years.

Clause 174

Non-Resident Withholding Tax

ITA
212

Section 212 of the Act is the principal provision dealing with the withholding tax imposed on payments to non-residents under Part XIII.

Subclause 174(1)

ITA
212(1)(b)(vii)

Subparagraph 212(1)(b)(vii) of the Act provides an exemption from the application of non-resident withholding tax for interest paid by a Canadian corporation to an arm's length non-resident on a debt obligation issued for a term of not less than 5 years. The amendment to clause 212(1)(b)(vii)(C), which applies to amounts paid or credited after 1986, corrects a typographical error and clarifies that the repayment of more than 25% of a debt obligation within 5 years of its issuance will not disqualify interest payments made thereunder from the non-resident withholding tax exemption if that repayment occurs as a result of a failure or default under the terms of the obligation or an agreement relating to the obligation.

Subclause 174(2)

ITA
212(1)(c)

Paragraph 212(1)(c) of the Act provides that a withholding tax will be exigible under Part XIII of the Act on any amount that is paid by a trust to a non-resident beneficiary and that would have been subject to tax under Part I of the Act if it had been paid to a person resident in Canada to whom Part I was applicable. The purpose of this rule is to apply a tax on any amounts, other than capital distributions, paid by a trust to non-resident beneficiaries. Paragraph 212(1)(c) is amended to provide that tax under Part XIII will also be payable on a capital distribution made by a trust to a non-resident where that distribution may reasonably be considered to relate to a capital dividend received by the trust. This amendment, which applies to amounts paid or credited by a trust or an estate after July 13, 1990, ensures that the withholding tax applying under paragraph 212(2)(b) of the Act with respect to capital dividends cannot be avoided by flowing such dividends through a trust resident in Canada.

Subclause 174(3)

ITA
212(11)

Subsection 212(11) of the Act provides that amounts paid by a trust to a non-resident beneficiary are considered to be income for the purposes of paragraph 212(1)(c) and, as such, are generally subject to a withholding tax under Part XIII of the Act. An exception to this rule is provided in the case of amounts which represent capital distributions from a trust. As a result of an amendment to paragraph 212(1)(c) which provides that Part XIII may apply to certain capital distributions as well as income distributions, the exception in subsection 212(11) with respect to capital distributions has been eliminated. This amendment, which applies to amounts paid or credited after July 13, 1990, is not intended to apply tax under Part XIII with respect to all capital distributions but, rather, is being made only to give effect to the amendment to paragraph 212(1)(c) which levies a tax on capital dividends flowed through a trust to non-resident persons.

Clause 175

Non-Arms Length Share Sales by Non-Residents

ITA
212.1(3)

Subsection 212.1(1) of the Act contains a special anti-avoidance provision applying to a non-resident person who disposes of shares of a Canadian corporation to another Canadian corporation with which the non-resident does not deal at arm's length.

Paragraph 212.1(3)(a) of the Act treats a non-resident taxpayer as not being at arm's length with a "purchaser corporation" if the taxpayer was, immediately before the disposition, one of a group of less than 6 persons that controlled the "subject corporation" and, immediately after the disposition, one of a group of less than 6 persons that controlled the purchaser corporation. For the purposes of applying this rule, paragraph 212.1(3)(b) treats shares that are owned by the taxpayer's spouse or certain corporations or inter vivos trusts as being owned by the taxpayer and not by the person who actually owned them.

Paragraph 212.1(3)(b) is amended, applicable to dispositions of shares after July 13, 1990, to treat shares owned by the taxpayer's child, as defined in subsection 70(10)(a) of the Act, as being owned by the taxpayer where the child is under 18 years of age. For these purposes, therefore, a taxpayer will be treated as owning shares held by a grandchild or great-grandchild of the taxpayer or by any person who is under the age of 18, is wholly dependent on the taxpayer for support and is under the taxpayer's custody and control.
Subparagraphs 212.1(3)(b)(ii) and (iii) are also amended to include, in determining whether a taxpayer is part of a group that controls a particular corporation, shares owned by any trust of which the taxpayer, the taxpayer's spouse or child or a corporation controlled by such persons is a beneficiary, as well as shares owned by a corporation that is controlled by the taxpayer, the taxpayer's spouse or child or a trust of which any such person is a beneficiary.

New paragraph 212.1(3)(c) provides that in determining, for the purposes of section 212.1 of the Act, whether a non-resident taxpayer has disposed of shares to a corporation with which he does not deal at arm's length, a trust and a beneficiary of the trust or a person related to a beneficiary of the trust will be treated as not dealing with each other at arm's length. As a result, a disposition by a non-resident trust to a corporation that is controlled by beneficiaries of the trust or persons related to such beneficiaries will be treated as a disposition to a corporation with which the trust does not deal at arm's length. New paragraph 212.1(3)(c) applies to dispositions of shares occurring after July 13, 1990.

Clause 176

Rules Relating to Non-Resident Withholding Tax

ITA
214(6) and (8)

Section 214 of the Act sets out special rules relating to the application of non-resident withholding tax.

In circumstances where a non-resident transfers a debt obligation to a resident, subsection 214(6) of the Act deems a payment of interest to have been made equal to the amount that would, if Part I were applicable, be included in the income of the transferor of the debt obligation by reason of subsection 20(14) of the Act. Certain obligations, defined in paragraph 214(8)(a) of the Act, are excluded from the application of subsection 214(6) of the Act.

Subparagraph 214(8)(a)(ii) is intended to describe the debt obligations referred to in subparagraph 212(1)(b)(vii) of the Act which are exempt from the non-resident withholding tax. New paragraph 214(8)(a) ensures that all debt obligations the interest on which is exempt from non-resident withholding tax under paragraph 212(1)(b)(vii) will be excluded from the application of subsections 214(6) and (7), including, for example, debt obligations exempted by reason of clause 212(1)(b)(vii)(E). In addition new paragraph 214(8)(a) ensures that the proviso in paragraph 212(1)(b) that exempted interest may not be contingent on use or production from property or computed by reference to revenue, profit or similar criteria applies equally to subsections 214(6) and (7). These amendments apply to obligations transferred after July 13, 1990.

Clause 177

Regulations re: Part XIII Liability

ITA
215(5)

Subsection 215(5) of the Act provides that the Governor in Council may make regulations reducing the rate of tax withheld from certain payments received by a non-resident.

Paragraph 212(1)(j) of the Act, which formerly imposed non-resident withholding tax on certain allowances and benefits described in subparagraphs 56(1)(a)(ii) to (viii) of the Act, was amended as of November 13, 1981 to delete the references to amounts described in subparagraphs 56(1)(a)(ii) (retiring allowances) and (viii) (termination payments). These amounts become taxable, instead, under paragraph 212(1)(j.1) of the Act.

The amendment to subsection 215(5) of the Act, which applies to amounts paid after July 13, 1990, adds a reference to paragraph 212(1)(j.1) and is intended to provide the Governor in Council with authority to make regulations reducing the amount otherwise required to be deducted or withheld under Part XIII of the Act in respect of retiring allowances, including termination payments. Subsection 809(4) of the Income Tax Regulations will also be amended, effective as of the same date, to include amounts described in paragraph 212(1)(j.1) in the definition "qualifying payment" for the purposes of applying reduced rates of withholding tax.

Clause 178

Rents and Timber Royalties

ITA
216(1)

Subsection 216(1) of the Act permits a person not resident in Canada to file a return of income under Part I of the Act in respect of rent on real property in Canada or timber royalties and to pay, in lieu of the non-resident withholding tax under Part XIII, tax under Part I on the basis of the non-resident's income from such rent or royalties.

This amendment to subsection 216(1) limits the period within which an election to file a return under Part I is permitted to six months following the end of the relevant taxation year where, pursuant to subsection 216(4) which permits an agent of a non-resident person to withhold only the net amount of such rents or royalties, the non-resident person has made an undertaking to the Minister of National Revenue to file a Part I return within that six month period. This amendment applies to taxation years ending after July 13, 1990.

Clause 179

Election Respecting Certain Payments

ITA
217(c)

Part XIII of the Act imposes a 25% tax on certain Canadian-source amounts paid to a person not resident in Canada, including alimony, pension benefits and payments from registered retirement savings plans, registered retirement income funds and retirement compensation arrangements. The 25% rate may be modified under a tax treaty entered into with the country in which the recipient of such payments is resident.

Section 217 provides an election for a non-resident person who receives payments of the nature set out above while not resident in Canada. As a consequence of this election, as provided under paragraph 217(b), such payments are not taxed under Part XIII but are instead added (with CPP and OAS benefits) in computing the individual's taxable income earned in Canada or, where the non-resident was a part-time Canadian resident, in computing the individual's taxable income. Both of these computed amounts would be subject to income tax at ordinary rates under Part I. (The payments so added in computing these amounts are referred to herein as "specified payments".)

Paragraph 217(c) allows an electing non-resident individual to claim personal tax credits under section 118, without having to satisfy the requirement under section 118.94 that all or substantially all of the individual's income be included in computing the non-resident's taxable income earned in Canada.

Section 217 is amended for the 1988 and subsequent taxation years so that an electing non-resident has access to the credits under sections 118.5 (tuition credit) and 118.7 (credit for UI premium and CPP contributions) without being required to satisfy requirements additional to those already in those sections. This amendment is parallel to a similar amendment to section 118.94 which eliminates the "all or substantially all" requirement described above in relation to those credits.

Section 217 is also amended for the 1988 and subsequent taxation years so that an electing non-resident has access to the tax credit in section 118.1 in respect of charitable gifts without having to satisfy the same "all or substantially all" requirement. This amendment is consistent with allowing such a credit for those non-residents who do not elect under section 217.

Section 217 is amended for the 1991 and subsequent taxation years so that the additional tax credits available to an electing non-resident individual by virtue of paragraph 217(c) are only available where more than half of the individual's income (including the specified payments described above) is included in the individual's taxable income earned in Canada or, where the individual was a part-time Canadian resident, in the individual's taxable income as generally determined under section 114.

Section 217 is also amended for the 1991 and subsequent taxation years so that the amount that may be claimed by an electing individual in respect of tax credits described under sections 118 to 118.9 is restricted

- where the individual so elects within amended paragraph 217(c) itself, to the "appropriate percentage" of the individual's specified payments, and

- in any other case, to the amount that the individual would be entitled to claim in respect of those credits without regard to the special rule in paragraph 217(c).

The appropriate percentage, as defined in subsection 248(1), is the lowest federal marginal tax rate (currently set at 17%). This new amendment ensures that a non-resident person with a relatively small amount of specified payments and significant amounts of other Canadian-source income will not, by virtue of section 217, effectively be able to use those tax credits to reduce Part I tax payable in respect of the other Canadian-source income.

The new election provided within paragraph 217(c) would never be advantageous for a full-time non-resident all or substantially all of whose income is included in the individual's taxable income earned in Canada. In these circumstances, there are no restrictions on the claiming of tax credits under sections 118 to 118.9 by the non-resident provided in section 118.94. In the case of a part-time Canadian resident individual, the relative advantage of this new election would depend on the individual's entitlement to the tax credits in sections 118 to 118.9, as determined under amended section 118.91 without reference to section 217.

Clause 180

Branch Tax

ITA
219(1)(f.1)

Part XIV of the Act levies a tax on corporations (other than Canadian corporations) carrying on business in Canada. In computing the amount on which this tax is based, subsection 219(1) permits, among other deductions, the deduction of tax payable by the corporation under Part I of the Act as well as any provincial income taxes payable by the corporation (to the extent that such taxes were not deductible in computing the corporation's income under Part I).

New paragraph 219(1)(f.1) provides that the amount of any interest or penalties paid by a corporation under the Act, or to a province on or in respect of provincial income taxes (other than any such amount that was deductible under Part I of the Act), in a taxation year may also be deducted in computing its tax payable under Part XIV for that year. This paragraph applies with respect to interest and penalties paid in the 1988 and subsequent taxation years.

Clause 181

Income Tax Administration

ITA
220

Section 220 of the Act sets out a number of rules relating to administration of income taxation.

Subclause 181(1)

ITA
220(3.1)

New subsection 220(3.1) of the Act, applicable to penalties and interest in respect of the 1985 and subsequent taxation years, gives the Minister of National Revenue discretion to waive or cancel part or all of a penalty or interest that is payable under the Act. This discretion will generally be exercised where taxpayers or partnerships have not complied with a requirement under the Act or a regulation or have failed to pay an amount when due because of extraordinary circumstances beyond their control.

The Minister will consider cancelling or waiving a penalty or interest upon application being made in writing. The taxpayer or partnership will be required to explain in the application why the penalty or interest should be cancelled or waived.

Examples of situations or events which may have caused a taxpayer or partnership to fail to comply with the provisions of the Act or a regulation and where the Minister would consider exercising discretion include:

- Natural or human-made disasters such as flood or fire.

- Civil disturbance or disruption in services, such as a strike.

- Recent serious illness or accident which prevented or delayed the filing of a return or making of a payment.

- Erroneous information from Revenue Canada, Taxation in the form of incorrect written answers or errors in published information.

The Minister will not exercise discretion under this provision unless the taxpayer or partnership has taken a reasonable amount of care in attempting to comply with the requirements. If possible, efforts should have been made to avoid, or at least minimize, the delay in complying or paying amounts due. Any delay or omission should be remedied within a reasonable time after the taxpayer or partnership became aware of the delay or omission.

If the delay in payment or compliance arose through neglect or lack of awareness on the part of the taxpayer or partnership, the penalty or interest will not be cancelled or waived.

Guidelines will be issued to explain further the circumstances under which the Minister will consider exercising this discretion.

ITA
220(3.2) to (3.7)

New subsections 220(3.2) to (3.7) of the Act, which apply to elections in respect of the 1985 and subsequent taxation years, are in respect of elections under certain provisions of the Act or the regulations that do not specifically provide for late, amended or revoked elections. The provisions in respect of which these new rules will apply will be set out in the Income Tax Regulations.

ITA
220(3.2)

New subsection 220(3.2) of the Act allows a taxpayer or partnership to apply to the Minister of National Revenue to make a late election or to amend or revoke a valid election previously made. The Regulations will identify the elections to which this new rule will apply. They will be the elections that are most frequently the subject of a request for a late or amended election not specifically covered by current legislation.

The purpose of this subsection is to give the Minister discretion to allow a taxpayer or partnership to make a late election where the taxpayer or partnership can demonstrate that the failure to elect on time was inadvertent or that the election would have been made on time had the taxpayer or partnership been aware of the election. Permission may also be granted to make a late election where it can be demonstrated that the election was not filed on time because of circumstances beyond the control of the taxpayer or partnership.

An amendment to, or a revocation of, an original election may be granted where it can be demonstrated that the original election would cause a tax result that was not intended by the taxpayer or partnership.

Since adequate records may not always be available, it may be necessary to reconstruct the taxpayer's return for one or more of the years in respect of the election. The taxpayer's assistance will be required in this regard. Depending on the adequacy of the records and the validity of the election, a late, amended or revoked election may be permitted.

The Minister will not grant permission to elect late or to amend or revoke an election where it is reasonable to conclude that such action would constitute retroactive tax planning. For example, if the Act were amended between the due date of an election and the date of the application for a late election and the taxpayer would be adversely affected by the amendment, the application would be denied.

Consideration will be given by the Minister to allow a late election or amended election or to allow an election to be revoked upon application being made, in writing and in the manner set out in the guidelines, by the taxpayer or partnership. The taxpayer or partnership will be required to explain in the application why the late or amended election should be accepted or the revocation of the election allowed.

Guidelines will be issued to explain further the circumstances under which the Minister will consider exercising this discretion.

It is proposed to list in section 600 of the Income Tax Regulations the provisions of the Income Tax Act and the Regulations in respect of which a taxpayer or a partnership can apply under new subsection 220(3.2) of the Act to make a late or amended election or to revoke an election. The following is the list of the provisions and a brief description of the nature of the election:

- Section 21 of the Act allows a taxpayer or partnership to elect to treat interest as a capital cost instead of an expense.

- Subsections 13(4), 14(6) and 44(1) of the Act allow a taxpayer or partnership to elect to defer an income inclusion or the recognition of a capital gain where a replacement property is acquired for a property that was stolen, expropriated or destroyed or for a former business property that was sold.

- Paragraphs 66.7(7)(c), (d) and (e) and (8)(c), (d) and (e) of the Act allow a predecessor corporation and a successor corporation to elect to transfer the unused pools of resource expenses from the predecessor to the successor.

- Subsection 70(6.2) of the Act allows a taxpayer's legal representative to elect to have the rollover rules under subsection 70(6) not apply, thus causing the assets transferred to a taxpayer's spouse on the death of the taxpayer to be considered to be transferred at fair market value for tax purposes.

- Subsection 70(9) of the Act allows a taxpayer's legal representative to elect an amount, within limits, as proceeds of disposition for farm property transferred to a child on the taxpayer's death.

- Subsection 70(9.1) of the Act allows a spousal trust to elect an amount, within limits, as proceeds of disposition for farm property transferred from the trust to a child on the spouse's death.

- Subsection 70(9.2) of the Act allows a taxpayer's legal representative to elect an amount, within limits, as proceeds of disposition for a share in a family farm corporation or an interest in a family farm partnership transferred to a child on the taxpayer's death.

- Subsection 70(9.3) of the Act allows a spousal trust to elect an amount, within limits, as proceeds of disposition for a share in a family farm corporation or an interest in a family farm partnership transferred from the trust to a child on the spouse's death.

- Subsection 72(2) of the Act permits a legal representative of a deceased taxpayer to elect to claim a deduction for certain reserves provided that the amount so deducted is subsequently included in the income of the taxpayer's spouse or a spousal trust.

- Subsection 73(1) of the Act allows a taxpayer to elect to have the rollover provisions in respect of an inter-vivos transfer of assets to a spouse or spousal trust not apply, thus causing the assets to be considered to be transferred at fair market value for tax purposes.

- Subsection 104(14) of the Act allows a trust and its preferred beneficiaries to elect to have the income of the trust included in the income of the preferred beneficiaries instead of being taxed as income of the trust.

- Subsection 1103(1) of the Regulations allows a taxpayer or partnership to elect, for capital allowance purposes, to include in Class 1 all properties included in Classes 2 to 12.

- Subsection 1103(2) of the Regulations allows a taxpayer or partnership to elect, for capital allowance purposes, to include in Class 2, 4 or 17 all properties included in any other classes where Class 2, 4 or 17 are the classes in which the chief depreciable properties of the taxpayer or partnership are included.

- Subsection 1103(2d) of the Regulations allows a taxpayer or partnership to elect to defer a capital cost allowance recapture by transferring the property disposed of to a new class of which the taxpayer or partnership has property where the property disposed of would have been a property of the new class if it had been acquired when the property of the new class was acquired.

ITA
220(3.3)

New subsection 220(3.3) of the Act provides that a late election or an amended election permitted to be made pursuant to new subsection 220(3.2) is deemed to have been made at the time the election was required to be made and that, in the case of an amended or revoked election, the original election is deemed never to have been made.

ITA
220(3.4)

New subsection 220(3.4) of the Act requires the Minister of National Revenue to reassess each taxation year of any taxpayer to take into consideration a late, amended or revoked election permitted by new subsection 220(3.2), even if the normal reassessment period for that year has expired.

ITA
220(3.5)

New subsection 220(3.5) of the Act provides that where, pursuant to an application under new subsection 220(3.2), the Minister permits a late, amended or revoked election, the applicant is liable to a penalty of $100 for each complete month from the due date of the election to the date the application was made, with a maximum penalty of $8,000.

ITA
220(3.6)

New subsection 220(3.6) of the Act requires the Minister to assess the penalty referred to in new subsection 220(3.5), and requires the taxpayer or partnership to pay the penalty. Paragraph 161(11)(c) of the Act requires the taxpayer or partnership to pay interest on the unpaid portion of the penalty assessed under new subsection 220(3.5) from the date of the notice of assessment to the date of payment.

ITA
220(3.7)

New subsection 220(3.7) of the Act provides that the interest, refund, objections and appeals provisions in Part I of the Act will apply to assessments made under section 220.

Subclause 181(2)

Security

ITA
220(4.3)(a)

Subject to certain limitations, subsection 220(4.3) of the Act entitles a member institution of a deposit insurance corporation to post security with Revenue Canada, Taxation for the payment of tax for a taxation year to the extent that the liability therefor resulted from the inclusion in the institution's income for the year of assistance received from the deposit insurance corporation.
Paragraph 220(4.3)(a) of the Act is amended, effective after July 13, 1990, to permit also the posting of security under this provision for tax payable for a particular taxation year that resulted from the inclusion of assistance in the institution's income for an earlier taxation year. This circumstance would arise where the income inclusion for the earlier year had eliminated a non-capital loss of the institution for the earlier year which would have been deductible in computing taxable income for the year for which the security is offered.

Clause 182

Reporting Requirements

ITA
221(3)

Paragraph 221(1)(d) of the Act allows the Governor in Council to make regulations requiring any class of persons to make an information return relating to information required in connection with assessments under the Act. Paragraph 221(1)(e) of the Act provides that the Governor in Council may also require, by regulation, those persons to provide a copy of that return to the person to whom the return relates.

New subsection 221(3) of the Act, which applies after 1990, provides that regulations made under paragraphs 221(1)(d) and (e) are applicable to Her Majesty in right of Canada or a province.

Clause 183

Application of Interest

ITA
221.1

New section 221.1 of the Act clarifies that after the enactment of an amendment to the Income Tax Act or a related provision, the provisions of the Act concerning interest apply from the taxation year in which the new provision becomes applicable unless a contrary intention is evident. Thus, for example, if an amendment to the Income Tax Act has the effect of increasing a person's tax due on a date before the amendment is ultimately enacted, Revenue Canada is not empowered before passage of the legislation to enforce collection of the increase in tax payable or any resulting interest; however, interest on such tax is calculated from the due date. As well, Revenue Canada is required to pay interest to taxpayers on any overpayment resulting from passage of a relieving amendment as if the amendment had come into force for the taxation year in which the amendment first applies.

This section is applicable with respect to amendments and enactments assented to or promulgated after 1989.

Clause 184

Collection Restrictions
ITA
225.1(5)

Subsection 225.1(5) of the Act imposes restrictions on collection actions by Revenue Canada, Taxation in cases where there has been an agreement to delay court proceedings pending the resolution of other court proceedings on the same or similar issues. Section 23 of S.C. 1988, c.61 would amend subsection 225.1(5), along with subsections 225.1(3) and (4), as a consequence of changes made by that Act to the Tax Court of Canada Act. Those amendments to subsections 225.1(3) and (4) have been superseded by other amendments to those subsections made by S.C. 1990, c.34 (Bill C-51) and, as a result, section 23 of S.C. 1988, c.61 is being repealed in this Bill. The amendments to subsection 225.1(5) of the Act that would have been made by section 23 of S.C. 1988, c.61 are made by this clause, effective on January 1, 1991, which is the day fixed by order of the Governor in Council for the coming into force of most of the amendments to the Tax Court of Canada Act.

Clause 185

Leaving Canada

ITA
226

Subsection 226(1) of the Act authorizes the Minister of National Revenue to demand immediate payment by a taxpayer of taxes not yet due if the Minister suspects the taxpayer is about to leave Canada. The amendment to subsection 226(1) will also authorize the Minister to make such a demand after a taxpayer has left Canada.

The amendment to subsection 226(2) of the Act changes the reference therein from "person" to "taxpayer" to correspond with the use of the latter term in subsection 226(1) and elsewhere in subsection 226(2).

These amendments are to be effective on Royal Assent.

Clause 186

Liability for Tax

ITA
227

Section 227 provides special rules relating to source deductions and non-resident withholding tax under sections 153 and 215, respectively, and also deals with the application of certain Parts of the Act to certain persons and entities.

Subclauses 186(1) to (3)

ITA
227(8.3) and (8.4)

Subsection 135(3) of the Act requires any person paying patronage dividend to a Canadian resident to withhold 15% of the payment and remit it to the Receiver General. Subsection 227(8) of the Act formerly provided that a person who failed to deduct the required amount would be liable for that amount together with interest therein. This liability was inadvertently eliminated in the context of an earlier amendment of subsection 227(8).

Subsections 227(8.3) and (8.4) of the Act, which together impose a similar liability for amounts required to be deducted or withheld under subsection 153(1) in respect of certain payments, are being amended, applicable after July 13, 1990, to reinstate the liability applying in respect of failures under subsection 135(3).

Subclause 186(4)

ITA
227(10)(a)

Paragraph 227(10)(a) of the Act, which empowers the Minister to assess any person for any amount payable by that person under various provisions of the Act, is amended to add to the listed provisions new section 235. New section 235 of the Act imposes a penalty for large corporations that fail to file certain returns. This penalty is described (below) in the explanatory notes on that section.

Subclause 186(5)

ITA
227(14)

Subsection 227(14) of the Act provides that certain Parts of the Act are not applicable to a corporation that is exempt from tax under Part I by reason of section 149 of the Act. Subsection 227(14) is amended, applicable after 1989, to delete therefrom the reference to Part III of the Act, which imposes a tax on excessive elections made by a corporation under subsection 83(2), 130.1(4) or 131(1) of the Act. As a result of this amendment, an exempt corporation will be subject to the provisions of Part III if, for example, it makes an election under subsection 83(2) in respect of a dividend payable by it and the amount of the dividend exceeds its capital dividend account at the relevant time.

Clause 187

Penalty

ITA
235

In a press release dated January 3, 1991, the Minister of Finance proposed a new penalty for large corporations that fail to file, as and when required, a tax return under Part I (income tax), Part I.3 (large corporations tax) or Part VI (financial institutions capital tax). New section 235 of the Act gives effect to this proposal.

The penalty under section 235 will be assessed at 1/4 of 1 per cent per month after the filing deadline on the combined amount payable under the large corporations tax and the financial institutions capital tax. The penalty is to apply separately for each late-filed return in respect of the large corporations tax, the financial institutions capital tax or the corporate income tax for each full month throughout which a return had not been filed as and when required under the Act. The penalty will be applied for complete months ending after the implementing legislation is enacted during which a return has not been filed as required.

Clause 188

Tax Shelters

ITA
237.1

Section 237.1 of the Act requires the promoter of a tax shelter to obtain an identification number from the Minister of National Revenue for the shelter before any sale or issuance of an interest in the shelter can be made. Subsection 237.1(1) of the Act provides the definition of "tax shelter" for the purposes of section 237.1. Under this definition, the determination of losses or other amounts deductible in respect of a shelter is to be made on a prospective basis. The amendment to subparagraph (a)(ii) of the definition "tax shelter" in subsection 237.1(1), which applies to interests acquired after August 1989, requires any amount represented to be deductible and expected to be incurred by or allocated to a person for a particular year or for any preceding taxation year to be taken into account for the purpose of determining whether a property is a tax shelter. This amendment achieves uniformity between subparagraphs (a)(i) and (ii) of the English version of the definition "tax shelter" and parallels subparagraph (a)(ii) of the French version of this definition.

Subsection 237.1(6) of the Act provides that no amount may be claimed or deducted under the Act by a taxpayer in respect of an interest in a tax shelter unless the taxpayer provides to the Minister of National Revenue the identification number for the shelter. Subsection 237.1(6) is being amended, effective for interests acquired after 1990, to add the requirement that the identification number for the shelter be filed with the Minister in a prescribed form containing prescribed information.

Clause 189

Communication of Social Insurance Number

ITA
239(2.3)

Subsection 239(2.3) of the Act prohibits a person who has been provided with an individual's Social Insurance Number pursuant to the Act or the regulations from using or communicating the number for a purpose other than that for which it was so provided. The amendments to this subsection extend this prohibition to officers, employees and agents of the person who was provided with the number. The amendments, effective on Royal Assent, also except from the offence any use or communication of the number: that is required or authorized by law; that occurs in the course of a person's duties in connection with the administration or enforcement of the Act; or for which the number was provided by the individual.

Clause 190

Communication of Information

ITA
241(4)(g), (l) and (m)

Paragraph 241(4)(g) of the Act permits certain information relating to the name, address and nature of a taxpayer's business obtained by Revenue Canada, Taxation to be communicated to departments and agencies of the Government of Canada, including StatsCan, for the purposes of enabling such entities to obtain statistical data for research and analysis. The amendment to paragraph 241(4)(g) of the Act, which applies after Royal Assent, provides that information concerning the size of a taxpayer's business may also be provided by officials or authorized persons of Revenue Canada, Taxation to departments and agencies such as StatsCan for such purpose.

New paragraph 241(4)(l) of the Act permits officials of Revenue Canada, Taxation to communicate information to the Department of Communications or members of the Canadian Cultural Property Export Review Board which may be relevant to determinations made by the Board under section 32 or 33 of the Cultural Property Export and Import Act. The Board has the responsibility for determining the fair market value of certain objects, their significance and their importance to Canada for the purposes of the provisions of the Income Tax Act concerning donations of certified cultural property to designated Canadian institutions. This amendment applies after Royal Assent.

New paragraph 241(4)(m) of the Act allows officials of Revenue Canada, Taxation to communicate information to other officials of that department, and to officials of other federal government departments, for the purposes of the recovery or collection, by way of set-off, of debts owed to the federal government or debts owed on account of taxes to a provincial government that has entered into a tax collection agreement with the federal government. The communication of such information could facilitate the set-off such debts against tax refunds. This new paragraph applies after Royal Assent.

Clause 191

Administration and Enforcement

Section 244 of the Act provides a number of rules which apply for purposes of the administration and enforcement of the Act.

Subclause 191(1)

ITA
244(14)

Under new subsection 166.1(5) of the Act, the Minister of National Revenue must, upon receipt of an application for extension of time to object to an assessment under section 165 of the Act or to make a request for adjustments with respect to a transaction under subsection 245(6) of the Act, consider the application and notify the taxpayer of his decision to grant or refuse it.

Subsection 244(14) of the Act provides that the date shown on a notice or notification sent by the Minister is considered to be, for the purposes of certain provisions, the date of mailing. The amendment to subsection 244(14), which applies upon Royal Assent, extends this rule to applications under new subsection 166.1(5). The amendment also removes references to subsections 192(8) and 194(7) of the Act, which are no longer necessary since the period of time during which late designations could be made under those provisions with respect to refundable tax on corporations issuing qualifying shares and in respect of scientific research and experimental development tax credits has expired.

Subclause 191(2)

ITA
244(16)

Subsection 244(16) of the Act provides that any form purporting to be prescribed or authorized by the Minister of National Revenue is to be considered to be a validly prescribed form unless challenged by the Minister or a person acting for the Minister or Her Majesty. This subsection is amended as a consequence of amendments to the definition "prescribed" in subsection 248(1) of the Act, which refer to forms "authorized", rather than "prescribed", by the Minister of National Revenue.

Subclause 191(3)

ITA
244(20)

New subsection 244(20), which applies on Royal Assent, provides that every member of a partnership is to be treated as having been named in any notice or document which contains a reference to the firm name of the partnership. This subsection also provides that all notices or documents mailed, served or sent to a partnership at the last known address or place of business of the partnership or any member thereof (or, in the case of a limited partnership, of any member thereof whose liability is not limited) shall be considered to have been provided to each member of the partnership. This amendment provides a more efficient manner in which to administer and enforce the Act, especially in cases where a partnership has a large number of members.

Clause 192

Interpretation

ITA
248

Section 248 defines a number of terms which apply for purposes of the Act, and also sets out various rules relating to the interpretation and application of various provisions of the Act.

Subclauses 192(1) to (14)

ITA
248(1)

For ease of reference, all of the amendments to subsection 248(1) are set out below in the alphabetical order of the definitions to which the amendments relate.

"automobile"

For the purposes of the Act "automobile" means a motor vehicle designed primarily to carry individuals on highways and streets and having a seating capacity of not more than nine people (including the driver) and a motor vehicle that is a station wagon or van if it is equipped to carry more than the driver and two passengers but not more than the driver and eight passengers. A van or pick-up truck designed to carry not more than 3 people (including the driver) and acquired primarily for the purposes of transporting goods or equipment in the course of earning income is excluded from the definition. Vehicles such as an ambulance, a motor vehicle acquired primarily for use as a taxi or in connection with funerals, and (other than for the purposes of paragraphs 6(1)(a) and (e) in respect of benefits arising from personal use of an employer's automobile) motor vehicles acquired for the purpose of selling, renting or leasing such vehicles are also excluded from the definition.

The definition of "automobile" is relevant to the limitation on the depreciable cost of a passenger vehicle, the equivalent restrictions on deductible lease payments in respect of leased passenger vehicles and the limitation on the deductibility of interest expenses with respect to passenger vehicles. In this regard, the definition "automobile" is amended to exclude

- a bus used in the business of transporting passengers,

- except for the purposes of section 6 of the Act, a motor vehicle used for the purpose of transporting passengers in the course of carrying on a business of arranging or managing funerals, and

- a motor vehicle of a type commonly called a van or pick-up truck or similar vehicle that is used all or substantially all for the transportation of goods, equipment or passengers in the course of gaining or producing income.

These amendments are applicable with respect to taxation years and fiscal periods commencing after June 17, 1987 that end after 1987.

"balance due day"

Subsection 248(1) of the Act is amended to introduce the definition "balance due day". This definition is relevant for the purposes of amended subsections 153(2), 155(1), 156(1) and 161(2.2) and amended section 156.1, each of which relate to the payment of tax instalments and arrears interest by individuals.

The "balance due day" in respect of an individual for a taxation year coincides with the normal filing deadline for the individual's tax return for the year. For most individuals, this day will be April 30 following the year. For trusts, the day will be 90 days following the year. For deceased individuals, the normal filing deadline is discussed in the commentary to paragraph 150(1)(b).

The purpose of this amendment, in conjunction with amendments to the other provisions referred to above, is to have the rules relating to tax instalments and arrears interest for deceased individuals and inter vivos trusts apply with reference to the balance due day rather than April 30th as under the existing law. The commentary on the amendments to the other provisions contains more detailed explanations in this regard.

This amendment is applicable after 1989.

"cash method"

Subsection 248(1) of the Act is amended to provide that the definition "cash method" in subsection 28(1) has the meaning described therein for all purposes of the Act. This amendment is applicable after 1988.

"cost amount"

Subsection 248(1) defines the expression "cost amount" which is used throughout the Act, particularly in provisions relating to transfers of properties to and from corporations, trusts and partnerships.

The "cost amount" of a single depreciable property in a class is the undepreciated capital cost of the property (i.e. the portion of the capital cost of the property that has not been deducted in computing income pursuant to the capital cost allowance regulations under paragraph 20(1)(a)). Where there is more than one depreciable property in a class, the cost amount of a particular property is determined by multiplying the undepreciated capital cost of the class by the proportion that the capital cost of the particular property is of the capital cost of all properties in the class.

The definition is amended as it relates to depreciable property to clarify that the cost amount to a taxpayer of a property of a class is determined without regard to the capital cost of other property in that class previously disposed of by the taxpayer. (Note that the undepreciated capital cost to a taxpayer of property of a class is reduced on the disposition of such property by the lesser of the capital cost to the taxpayer of such property and the taxpayer's proceeds from the disposition of such property.)

The definition is also amended as it relates to depreciable property to modify the application of the special rules in paragraphs 13(7)(b) and (d), which can have the effect of lowering the cost amount of depreciable property, for the purpose of the definition. Paragraph 13(7)(b) applies where the use of depreciable property for the purposes of gaining or producing income has commenced by a taxpayer. In these circumstances, the capital cost of the property to the taxpayer is deemed to be the fair market value of the property at the time of the change of use, but is limited in general terms to the sum of the capital cost of the property before the change of use and the amount of the taxpayer's taxable capital gain resulting from the change in use minus any related claim by the taxpayer for the capital gains exemption under section 110.6. The definition is amended so that this limitation, and a similar limitation with respect to the increased use of property in paragraph 13(7)(d), is ignored for the purposes of computing the cost amount of depreciable property.

The definition is further amended as it relates to depreciable property so that the special rule in paragraph 13(7)(e) (discussed in the commentary to the amendment to that paragraph) is also ignored for the purposes of determining the "cost amount" of depreciable property.

The purpose of the amendments relating to the "cost amount" of depreciable property and subsection 13(7) is to ensure that the special rules in that subsection do not apply for the purpose of determining capital gains in respect of depreciable property, to the extent those rules are inconsistent with the rules in subsection 45(1) dealing with the change in use of property for capital gains purposes. There is, for example, no rule equivalent to paragraph 13(7)(e) in subsection 45(1). Thus, the adjusted cost base to a person for capital gains purposes of a property that has been distributed to the person on a roll-over basis by a partnership or trust under subsection 98(3), 98(5) or 107(2) is to be determined without regard to any reduction in the "cost amount" of such property to the trust or partnership pursuant to paragraph 13(7)(e).

The "cost amount" of eligible capital property of a taxpayer in respect of a business is defined as the cumulative eligible capital of the taxpayer in respect of the business. There is no pro-ration rule provided in the event that the taxpayer has more than one eligible capital property for which "cost amount" is required to be separately determined.

This definition, is therefore, amended as it relates to eligible capital property to provide for such a pro-ration. Where a taxpayer has more than one eligible capital property in respect of a business, the cost amount to the taxpayer of a particular eligible capital property at any time is determined by multiplying the cumulative eligible capital of the taxpayer in respect of the business at that time by the proportion that the fair market value of the particular property at that time is of the fair market value of all eligible capital property of the taxpayer in respect of the business at that time.

The definition is also amended as it relates to eligible capital property so that the application of subsection 14(3), which can have the effect of lowering the cost amount of eligible capital property, does not apply for the purposes of the definition. Subsection 14(3) is discussed in the commentary on the amendments to that subsection.

The amendments relating to depreciable property apply after May 22, 1985. The amendments relating to eligible capital property apply after 1987, except that the new pro-ration rule applies only after July 13, 1990.

"dividend"

The definition "dividend" in subsection 248(1) currently treats all stock dividends as dividends for the purposes of the Act. This amendment, which applies to dividends paid to a corporation or a mutual fund trust after 1990 (and, where the corporation or trust so elects, after May 23, 1985 and before 1991), excludes stock dividends paid to a corporation from a corporation not resident in Canada from the definition "dividend" in subsection 248(1).

"foreign retirement arrangement"

This amendment adds the definition of "foreign retirement arrangement" to subsection 248(1) of the Act. This definition is relevant to amended paragraph 56(1)(a) of the Act under which amounts received in respect of a foreign retirement arrangement are included in income. The definition is also relevant for the purposes of paragraphs 12(11)(a), 60(j), 81(1)(r), 94(1)(b), 108(1)(j) and 127.52(1)(a) and subsection 104(27).

A foreign retirement arrangement is defined as a prescribed plan or arrangement. For this purpose, it is intended to prescribe Individual Retirement Accounts referred to in subsections 408(a), (b) and (h) of the United States Internal Revenue Code.

This amendment is applicable to the 1990 and subsequent taxation years.

"former business property"

The definition "former business property" in subsection 248(1) of the Act is amended to extend the benefit of the replacement property rules contained in subsection 13(4) and section 44 of the Act to situations where a former business property was owned by one corporation but used in the business of a related corporation (other than the business of gaining or producing gross revenue that is rent) rather than in the corporation's own business. These amendments apply with respect to dispositions of property occurring after July 13, 1990.

"grandfathered share"

Subsection 248(1) of the Act sets out the definition of "grandfathered share", which is relevant for the purposes of subsection 112(2.2) of the Act and the definitions of short-term preferred share and taxable preferred share in subsection 248(1). This amendment adds to the definition of grandfathered share a share issued in exchange for a debt obligation that was itself issued after 8:00 p.m. E.D.S.T, June 18, 1987 and before 1988 as part of a public distribution made in accordance with the terms of a prospectus or similar document filed with the appropriate public authority before 8:00 p.m. E.D.S.T., June 18, 1987. In addition, this definition is amended to include shares issued upon the exercise of a right listed on a prescribed stock exchange, where the right was issued pursuant to an agreement in writing made before 8 p.m. E.D.S.T., June 18, 1987 or where the right was issued before 1988 as part of a distribution to the public made in accordance with a prospectus or similar document filed with a public authority before 8 p.m. E.D.S.T., June 18, 1987.

This amendment applies to shares issued, and deemed by the Act to have been issued, after 8:00 p.m. E.D.S.T., June 18, 1987.

"home relocation loan"

Paragraph (b) of the definition "home relocation loan" in subsection 248(1) of the Act requires, as one criterion in determining whether a loan is a home relocation loan, that the loan be used to enable an individual who has moved to a new work location to acquire a dwelling for that individual's habitation. This paragraph is amended, applicable to the 1985 and subsequent taxation years, to include a loan used to acquire a share of a co-operative housing corporation for the purpose of enabling the individual to inhabit a dwelling unit owned by the corporation.

"inventory"

The definition "inventory" in subsection 248(1) of the Act is amended, with application to fiscal periods commencing after 1988, to clarify that a farmer's livestock is included in inventory irrespective of whether that farmer uses the cash method of accounting or accrual accounting for tax purposes.

"prescribed"

The definition "prescribed" in subsection 248(1) of the Act is being amended to extend its application to the manner of filing forms or of making or filing elections under the Act. It is also amended to refer to forms "authorized", rather than "prescribed", by the Minister of National Revenue as prescribed forms for the purposes of the Act.

This amendment is to be effective on Royal Assent.

"registered national arts service organization"

This amendment adds the definition "registered national arts service organization" to subsection 248(1) of the Act. This definition is relevant for the purposes of new paragraph 56(1)(aa) and new subsections 149.1(6.4) and (6.5) of the Act relating to the tax treatment of national arts service organizations and their members. This amendment is applicable after July 13, 1990.

"share"

"Share" is defined in subsection 248(1) of the Act as a share or fraction thereof of the capital stock of a corporation. This definition is amended, applicable after 1988, to clarify that a share of a cooperative corporation (as defined in subsection 136(2) of the Act) or credit union (as defined in subsection 248(1)) will also constitute a "share" for the purposes of the Act.

"small business corporation"

A number of amendments have been made to the definition "small business corporation" in subsection 248(1). A reference to subsection 110.6(15) has been added to alert taxpayers to the relieving provisions of that subsection relating to life insurance policies and proceeds held by the corporation.

Paragraphs (a) and (b) of the definition impose certain tests relating to the types of assets which such a corporation must hold. Paragraph (a) of this definition requires that all or substantially all of the corporation's assets (other than shares or debt) be used in an active business carried on primarily in Canada. This amendment, which applies to the 1988 and subsequent taxation years, provides that in determining whether an asset is used in an active business carried on primarily in Canada, it is the principal use of the asset that is relevant.

Pursuant to paragraph (b) of this definition, a corporation may be a small business corporation where its assets consist of shares of the capital stock of, or certain debt obligations issued by, one or more connected corporations that are themselves small business corporations. Paragraph (b) is amended, applicable to the 1988 and subsequent taxation years, to extend the range of eligible debt obligations that the corporation may hold in connected small business corporations to include indebtedness of any kind, whether issued or not. This change provides flexibility to Canadian-controlled private corporations whose assets include receivables or other indebtedness of, for example, a subsidiary corporation that are not bonds, debentures, bills, notes, mortgages, hypothecs or similar obligations issued by the subsidiary.

"stock dividend"

The definition of "stock dividend" in subsection 248(1) is amended only for greater certainty and is intended to clarify that this definition is to be interpreted without reference to the definition of "dividend" in subsection 248(1).

"taxable Canadian property"

The definition "taxable Canadian property" in subsection 248(1) of the Act is amended to include a life insurance policy in Canada, which is defined in paragraph 138(12)(g) of the Act (and applies for the purposes of the Act by reason of subsection 248(1)) to be a life insurance policy upon the life of a person resident in Canada at the time the policy was issued or effected. This amendment, which applies to dispositions occurring after July 13, 1990, is intended to ensure that a non-resident person who disposes of such a policy will be liable for tax on the disposition in the same manner as a person resident in Canada.

"term preferred share"

The definition "term preferred share" defines those shares the dividends on which are denied the intercorporate dividend deduction if received by a specified financial institution in certain circumstances. This amendment to paragraph (a) of this definition, which applies after June 18, 1987, corrects an earlier drafting omission.

Subclause 192(15)

ITA
248(3)

Subsection 248(3) of the Act provides that property in respect of which a person has certain rights provided by the laws of the Province of Quebec is deemed to be beneficially owned by that person for the purposes of the Act. This provision is made necessary by the fact that the concept of beneficial ownership used in the Act is unknown to the laws of that Province.

The amendment extends and clarifies the scope of this subsection.

In addition to the rule defining the concept of beneficial ownership in relation to the laws of the Province of Quebec, new subsection 248(3) contains rules that deem certain relationships or arrangements created under those laws to be trusts for the purposes of the Act.

New paragraphs 248(3)(a), (b) and (c) provide that usufructs, rights of use or habitation and substitutions under Québec laws are, for the purposes of the Act, deemed to be trusts and that property subject to such institutions is deemed to be held in trust and not otherwise. It is also provided that where these institutions are established by will upon someone's death (as opposed to inter vivos) they will give rise to a deemed trust that is likewise created by will. This is meant to ensure the proper application of the rollover provision for spousal trusts in subsection 70(6) to these new civil law deemed trust. Similarly it is provided that the trust property is deemed to have been transferred to the trust and, where the particular trust arises on death, it is further provided that such transfer occurs on death and as a consequence thereof. The latter rules also ensure the proper application of the inter vivos spousal trust transfer rules in subsection 70(3) and of the income attribution rules in section 74.1 and following, to the new civil law deemed trust. These new paragraphs are intended to make all the provision of the Act concerning trusts applicable in respect of the new trusts. For example, since the usufructuary has the control and the administration of property subject to an usufruct, the usufructuary will, pursuant to subsection 104(1) of the Act, be considered to be the trustee of the deemed trust created by new paragraph 248(3)(a). Similarly, the user in a right of use or habitation and the institute in a substitution would be considered as the trustees of the deemed trusts created under paragraph 248(3)(b) or (c) as the case may be. Further, where a taxpayer establishes an inter vivos usufruct in favour of another person with respect to property that he owns, he will be deemed to have transferred that property to a trust of which the other person is a beneficiary.

Also, new paragraph 248(3)(d) provides that an arrangement established by a written contract under the Quebec laws shall be treated as a trust and not otherwise provided that the rights and obligations created under that arrangement are similar to those under a trust and provided that the contract specifically provides that, for the purposes of the Income Tax Act, the arrangement will be treated as such. This will allow for the characterization, in the Province of Quebec, of certain entities as trusts under the Act even though they may not technically constitute trusts under the civil law of that Province.

New paragraph 248(3)(e) clarifies that a person who has any right to receive the income or the capital in respect of property that is deemed, under new paragraphs (a), (b), (c) or (d), to be held in trust shall be deemed to be beneficially interested in such trust. That person will thus be a beneficiary of the trust under the definition in paragraph 108(1)(b) of the Act.

New paragraph 248(3)(f) is essentially similar to existing subsection 248(3). Since usufruct and substitutions are now considered to be trusts under paragraphs (a) and (b) (see above), there is no longer a need for a specific reference to these entities. Paragraph (f) also clarifies that, in all the cases covered by the paragraph, a property shall be beneficially owned even if there is a servitude in respect thereof.

This amendment is applicable to property that is acquired or that becomes subject to a usufruct, a right of use or habitation, a substitution, a trust or an emphyteutic lease after 1990 or that becomes subject to an arrangement that meets the conditions of new paragraph 248(3)(c) in the 1989 or any subsequent taxation year. An election is provided for the application of the deemed trust rules after 1989 where a usufruct, a right of use or habitation or a substitution is established after 1989 in relation to property and the persons so acquiring an interest in such property elect jointly for an early application by notifying the Minister of National Revenue in writing before 1992.

Subclause 192(16)

ITA
248(11)

Subsection 248(11) of the Act provides for interest which is computed at a prescribed rate under certain provisions to be compounded on a daily basis. The amendment deletes the reference to section 211.5, which has been made redundant by the changes described in the commentary to that section. This amendment applies to the 1990 and subsequent taxation years.

Subclause 192(17)

ITA
248(14)

Subsection 248(14) of the Act treats two or more corporations as being related to each other where the purpose of the separate existence of those corporations is to limit or avoid the application of subsection 112(2.1) or (2.2) or 138(6) of the Act. This amendment, which applies after July 13, 1990, is intended to confirm that particular corporations deemed to be related to one another by reason of subsection 248(14) are also to be treated, for the purposes of paragraph (g) of the definition "specified financial institution" in subsection 248(1), as being related to all other corporations to which either of those particular corporations are related.

Subclause 192(18)

ITA
248(19)

New subsection 248(19) of the Act provides that the expression "available for use" shall, except where otherwise provided, be considered to have the same meaning for all purposes of the Act as it has for the purposes of subsection 13(26) of the Act relating to capital cost allowance. This expression is described in the commentary on subsection 13(26) and is relevant also for the purpose of sections 37 relating to research expenditures and 127 relating to investment tax credits as well as section 20 relating to capital cost allowance.

New subsection 248(19) of the Act is applicable after 1989.

ITA
248(20)

New subsection 248(20) of the Act clarifies the tax consequences of the partition of property previously owned jointly by two or more persons. This provision applies notwithstanding the fact that, pursuant to the relevant provincial laws, such partition may have a declaratory or retroactive effect so as to deem a person never to have been the owner of, nor to have disposed of an interest in, the property.

This subsection generally provides that the partition will result in a person acquiring or disposing of, as the case may be, an interest in a particular property to the extent of the change, resulting from the partition, of the fair market value of his interest in that property.

Paragraphs 248(20)(a) and (b) apply with respect to that part of the fair market value of an interest in the property that a person has kept following the partition. Such part is considered not to have been acquired nor disposed of upon the partition.

Paragraph 248(20)(c) applies where the fair market value of the interest of a person in a particular property is reduced following the partition. In this case, that person shall be considered to have owned until the partition, and to have then disposed of, that part of his interest that corresponds to the reduction in the fair market value thereof.

Conversely, paragraph 248(20)(d) applies where the partition results in the increase of the interest of a person in a property; in that case, the part of the interest of that person in the property that corresponds to the increase shall be deemed not to have been owned by that person before the partition and to have then been acquired.

Paragraph 248(20)(e) provides that the rules in paragraphs (a) to (d) do not apply where a person has an interest in fungible tangible property and that interest is included in that person's inventory. This exception would generally apply, for example, where a corporation engaged in the joint exploitation of an oil well obtains the full ownership of a particular oil shipment in satisfaction of its undivided interest in the oil extracted from the well.

The closing words of subsection 248(20) clarify that, for the purposes of paragraphs (a) to (d), the fair market value of an ownership interest in a property is considered to be a prorated portion of the property's fair market value and will not, therefore, be discounted to reflect the fact that the property is jointly owned or that the interest is a minority interest.

The following example illustrates the application of paragraphs 248(20)(a) to (d). Assume that A has a 50% share, as a co-owner, of property 1, which has a fair market value of $200,000, and of property 2, which has a fair market value of $250,000.

Following the partition of the properties, A becomes sole owner of property 1 in exchange for his interest in property 2. In addition A receives $25,000 in consideration for the difference in the fair market value of the two properties.

Pursuant to paragraphs 248(20)(a) and (c), A shall be deemed not to have disposed of the part of his interests in property 1 and 2 that corresponds to the following proportions and to have disposed of the other part:

	Property 1	Property 2
Fair market value of his interest after partition : Fair Market value of his interest before partition	$200,000 / $100,000 = 200%	$ O / $125,000 = 0%

A will therefore be deemed not to have disposed of any part of his interest in property 1 and to have disposed of all of his interest in property 2.

Pursuant to paragraphs 248(20)(b) and (d), A shall be deemed not to have acquired the part of his interest in property 1 that corresponds to the following proportion, and to have acquired the other part:

	Property 1
Fair market value of his interest before partition / Fair market value of his interest after partition	$100,000 / $200,000 = 50%

A will therefore be deemed to have acquired a 50% interest in property 1.

The proceeds of disposition of A's interest in property 2 are equivalent to what he received upon the disposition, i.e., an interest in property 1 worth $100,000 plus $25,000. The cost of the interest that A acquired in property 1 is the value of the interest in property 2 that he gave in exchange, i.e. $100,000.

New subsection 248(20) of the Act applies after July 13, 1990 except that it does not apply to partitions made after July 13, 1990 and before 1992 if they are made pursuant to a partition agreement dating from before July 14, 1990 evidenced in writing or if they are the subject of a confirmation by Revenue Canada or a provincial Revenue Department issued in respect of a request received before July 13, 1990.

ITA
248(21)

New subsection 248(21) of the Act provides an exception to the general rule that the partition of a property causes a disposition of some of the undivided interest therein. This exception applies when a property is subdivided and distributed (in whole or in part) between its owners in the course of a partition in such a way that each owner preserves a share of the fair market value of the property - a share that bears the same proportion to the fair market value of all the shares in the property, as the fair market value of that owner's undivided interest in the property bears to the fair market value of all the undivided interests in the property immediately before the partition. If the property is not so subdivided proportionately (even if its joint owners make up for such disproportionate shares by cash contributions or by a disproportionate allocation of the debt affecting the property), subsection (20) and not (21) will apply. Typically the exception will apply to the subdivision of land and buildings between joint owners.

When this exception applies, the rules in subsection (20) are not applicable and the new interest that each owner has pursuant to the partition is deemed to be a continuation of that owner's undivided interest such that the tax values and characteristics (cost, undepreciated capital cost, status as inventory or capital property, etc.) of the previous interest flow to the new interest.

The following is an example of the application of the exception: Two sisters and their brother are the joint owners (in equal shares) of a parcel of land inherited upon their mother's death. The mother's estate was wound up some time ago and the three siblings have, since then, held the property as tenants in common. The property is now worth $300,000 and it has a total adjusted cost base of $30,000 to the three children. Under new subsection (21) the three children may subdivide the property among themselves so that each one has $100,000 worth in land (eg. 1/3 of the fair market value of the land). Since their respective undivided interest in the property before partition was also worth $100,000 (1/3 of $300,000) the new divided interests would be the continuation of the previous undivided interests such that the adjusted cost base of $10,000 (1/3 of $30,000) would flow to each new divided interest.

However, if the property in the example above was charged with a mortgage of $150,000 and the joint owners arranged as part of the partition that one of them would receive a share of the land worth only $50,000 (instead of $100,000) but at the same time would obtain a discharge from his share of the mortgage obligation ($50,000) or alternatively would get a cash payment of $50,000, subsection (21) will not apply since the joint owners will have increased or decreased, as the case may be, their proportionate interests. Rather, subsection (20) will deem a disposition (acquisition) by every joint owner of their interests in the respective subdivisions.

Special interpretative rules exist for this exception. First, paragraph (21)(c) provides that for the purposes of this rule separate lots that result from the subdivision of a parcel of land are to be regarded as "a property" rather than separate properties. If it were not for this rule, a distribution or allocation of lots following a subdivision of a parcel of land might not technically be possible under the main rule. Similarly it is understood that units of a condominium or adjacent parcels of land owned jointly by the same persons, although they may have been acquired on separate occasions, may be viewed as a property for these purposes. Another special rule in paragraph 21(d) provides, that in computing the fair market value of an undivided interest, no premium or discount is to be applied for majority or minority interests. New subsection (21) applies after July 13, 1990.

ITA
248(22) and (23)

New subsections 248(22) and (23) of the Act, which apply after July 13, 1990, provide rules with respect to property in which both spouses have an interest under a matrimonial regime and that could therefore be subject to partition upon the dissolution of the regime. The purpose of these rules is to clarify the tax treatment of the income and the capital gains attributable to that property during the regime and upon its dissolution.

Subsection 248(22) of the Act deals with the ownership of such property. Paragraph 248(22)(a) applies with respect to property that was owned continuously by one spouse beginning immediately before such property became subject to the regime. It provides that such property is deemed to be owned exclusively by the spouse notwithstanding the interest of the other spouse therein.

Paragraph 248(22)(b) deals with property that does not meet the condition set forth in paragraph (a) either because it was subject to the matrimonial regime from the moment it was acquired or because it was disposed of by one spouse in favour of the other during the existence of the regime. Such property is deemed to be owned by the spouse who has the administration of it.

Subsection 248(23) of the Act applies where, as a consequence of the partition of property upon the dissolution of a matrimonial regime, property that was property of one spouse immediately before the dissolution of the regime is allocated to the other spouse or the estate of that other spouse. In that case, such property is deemed to have been transferred by the former spouse to the latter immediately before the dissolution. However, if such dissolution results from the death of one spouse, such transfer is deemed to have occurred immediately before the deemed disposition on death resulting from subsections 70(5) and (6) of the Act.

ITA
248(24)

New subsection 248(24) of the Act, which provides that the equity and consolidated methods of accounting shall not be used, is enacted for greater certainty. Thus, for example, any reference in the Act to the retained earnings on shareholders' equity of a corporation or paid-up capital in relation to shares of the capital stock of a corporation are determined on an unconsolidated basis and without regard to the amounts of any subsidiary or other corporation.

Clause 193

Acquisition of Control of a Corporation

ITA
249(4)

Where control of a corporation is acquired by a person or group of persons at any time, subsection 249(4) of the Act treats the taxation year of the corporation as having ended immediately before that time and a new taxation year of the corporation as having commenced at that time. The principal purpose of this subsection is to ensure that the loss carry-over restrictions in section 111 of the Act may be applied to losses realized and accrued both before and after the acquisition of control. Two amendments are being made to this subsection, applicable to acquisitions of control occurring after July 13, 1990.

The first amendment to subsection 249(4) clarifies that the rules in that subsection do not apply to acquisitions of control of a corporation that is a foreign affiliate of a taxpayer resident in Canada where the affiliate has not carried on a business in Canada in the year in which the acquisition of control occurs. The second amendment to subsection 249(4) simply confirms the intention that the rules contained therein apply for the purposes of the Act.

Clause 194

Residence

ITA
250(6)

Section 250 of the Income Tax Act provides certain rules for determining a person's residence for the purposes of the Act. New subsection 250(6) establishes rules for determining the residence of a corporation that is incorporated outside Canada where its principal business in a taxation year consists of the operation of ships used primarily in transporting passengers or goods in international traffic and all or substantially all of its gross revenue for the year is from the operation of ships in transporting such passengers and goods. For the purposes of this subsection, the definition of "international traffic", which is contained in subsection 248(1) of the Act, will be applied on the basis: first, that the corporation is not resident in Canada and, second, that voyages having a departure point or a destination on the Great Lakes or Saint Lawrence River will not be considered as international traffic where the destination or departure point, as the case may be, of the voyage is in Canada.

Where a corporation meets these conditions (and has not been granted articles of continuance in Canada), proposed subsection 250(6) will deem the corporation to be resident throughout the year in the country in which it was incorporated and not to be resident in Canada. This provision does not, however, preclude the possibility that a corporation may also be resident in a country other than Canada or the country of its incorporation.

This amendment is applicable to taxation years commencing after February, 1991.

Clause 195

Control

ITA
251(5)(b)

For the purposes of the definition of "Canadian-controlled private corporation" under paragraph 125(7)(b) of the Act and for the purposes of determining whether persons are related to each other under subsection 251(2) of the Act, paragraph 251(5)(b) of the Act applies to treat a taxpayer who has a right under a contract, in equity or otherwise, to acquire shares of a corporation as being in the same position in relation to the control of the corporation as if he owned the shares. Similarly, where the taxpayer has a right to cause a corporation to redeem, acquire or cancel shares of its capital stock owned by other shareholders of the corporation, the taxpayer will be treated as being in the same position in relation to control of the corporation as if the shares had been redeemed, acquired or cancelled.

An exception to this treatment exists where the contract provides that the right is not exercisable until the death, bankruptcy or permanent disability of an individual designated therein. This amendment to paragraph 251(5)(b), which applies after July 13, 1990, extends the scope of this exception to include, in addition to contractual rights, equitable rights and other rights not yet exercisable because their exercise is contingent upon the death, bankruptcy or permanent disability of an individual.

Clause 196

"spouse"

"former spouse"

ITA
252(3)

Subsection 252(3) of the Act provides extended definitions of the terms "spouse" and "former spouse" to include a party to a voidable or void marriage for certain specified purposes of the Act. This amendment, which applies after 1989, extends the application of this provision to new subsections 148(8.1) and (8.2) relating to transfers by a taxpayer of a life insurance policy to the taxpayer's spouse. The extended definition of spouse will also apply for the application of the rules in new subsections 248(22) and (23) relating to the treatment of property on the dissolution of a matrimonial regime.

Clause 197

Carrying on Business

ITA
253

Section 253 of the Act ensures that a non-resident person will be considered to be carrying on business in Canada where the activities specified in paragraphs 253(a) and (b) are carried out by the non-resident person. In such a case, the non-resident person would be subject to Part I tax by reason of subsection 2(3) and section 115 in respect of the income from such activities.

Section 253 of the Act is amended to ensure that a non-resident person who disposes of property (other than capital property) that is

- Canadian real estate (including an interest or option with respect to Canadian real estate), or

- timber resource property (including any interest or option with respect to timber resource property)

will be considered to carry on business in Canada in respect of such disposition. The amendment also applies where a non-resident person to whom subsection 66(5) applies disposes of Canadian resource property. The amended section ensures that the proceeds from the disposition of any such properties will be included in business income and subject to Canadian tax. This amendment applies with respect to dispositions after February 20, 1990, other than dispositions pursuant to agreements in writing entered into before February 21, 1990.

Section 253 is also amended so that, for the 1990 and subsequent taxation years, it applies to trusts resident in Canada to which Part XII.2 of the Act applies. The Part XII.2 tax payable by such a trust is calculated with reference to the designated income of trust, which includes income from businesses carried on in Canada. Such income is to be determined on the same basis for such trusts as it is for non-resident persons.

Clause 198

Associated Corporations

ITA
256

Section 256 of the Act sets out certain rules for determining whether corporations are considered to be associated, and for determining whether control of a corporation has been acquired, for the purposes of the Act.

Subclause 198(1)

ITA
256(1.1)

Subsection 256(1.1) of the Act defines "specified class" of shares for the purposes of the associated corporation rules. Shares of a specified class may be disregarded in applying certain provisions of section 256, thus facilitating investment by a person in corporations controlled by related persons without risking the consequences of association. Paragraph (d) of the definition imposes the requirement that the annual rate of the dividend on such shares, measured against the fair market value of the consideration for which the shares were issued, not exceed the prescribed rate of interest at the time the shares were issued. Prior to 1984, however, there was no prescribed rate of interest applicable generally for the purposes of the Act. Paragraph 256(1.1)(d) is therefore amended, effective for the 1989 and subsequent taxation years, to provide that the interest rate applying to shares issued prior to 1984 is the rate that was prescribed, for the purposes of subsection 161(1) of the Act, at the time the shares were issued. Prior to 1984 that rate varied between 6% and 16% and was set out in Regulation 4300(1). For shares issued after 1983, the rate applicable for the purposes of paragraph 256(1.1)(d) is the rate prescribed for the purposes of the Act in Regulation 4301.

Subclause 198(2)

ITA
256(1.3) and (1.4)

Subsection 256(1.3) of the Act applies, for purposes of the associated corporation rules, to treat the parent of a child who is under 18, or a group of persons of which the parent is a member, as owning shares of the capital stock of a corporation that are owned by the child, unless the child manages the business and affairs of the corporation without a significant degree of influence by the parent.

Subsection 256(1.3) can, under certain circumstances, operate to associate corporations that would not be associated if the shares in question had been owned directly by the parent. For example, parent and child own 90% and 10%, respectively, of the shares of Corporation A. Parent and a stranger each own 50% of the shares of Corporation B. Subsection 256(1.3), when read in conjunction with paragraphs 256(1)(b) and 256(1.2)(a) and (b), operates to treat Corporations A and B as being associated since, by treating the child's 10% shareholding to be owned by the group consisting of parent and stranger, both of the corporations will be considered to be controlled by the same group -- parent and stranger. This result is not appropriate since the two corporations would not, generally, be associated if the parent had owned all of the shares of Corporation A directly. Subsection 256(1.3) is therefore amended by deleting therefrom the words "or the group, as the case may be", in order to treat only the parent, and not the group as a whole, as owning the shares held by the parent's child.

Subsection 256(1.4) of the Act applies, for the purposes of determining whether corporations are associated, to treat a person or partnership as owning shares of a corporation in respect of which that person or partnership has a right under contract, in equity or otherwise, to acquire or control the voting rights of those shares. Similarly, where a person or partnership has a right to cause a corporation to redeem, acquire or cancel shares of its capital stock owned by other shareholders of the corporation, the person or partnership will be treated as being in the same position in relation to control of the corporation and ownership of its shares as if the shares had been redeemed, acquired or cancelled.

An exception to this treatment exists where the contract provides that the right is not exercisable until the death, bankruptcy or permanent disability of an individual designated therein. This amendment to subsection 256(1.4) extends the scope of this exception to include, in addition to contractual rights, equitable and other rights not yet exercisable because their exercise is contingent upon the death, bankruptcy or permanent disability of an individual.

Subsection 256(1.4) has also been amended to clarify that it is applicable in the case of two or more corporations, where one of the corporations holds the right to acquire shares of the other or the right to cause the other to redeem, cancel or acquire shares of its capital stock owned by other shareholders.

Subsections 256(1.3) and (1.4) were added to the Act in 1988. Generally, however, they do not take effect until the 1989 or 1990 taxation years. The amendments to subsections 256(1.3) and (1.4) are to be effective as of the date on which those subsections originally commenced to apply.

Subclause 198(3)

ITA
256(7)

Subsection 256(7) of the Act contains rules for determining whether or not there has been an acquisition of control of a corporation for the purposes of certain provisions of the Act. New subsection 85(1.2) provides that a non-resident may not transfer real property to a Canadian corporation on a tax-deferred basis under subsection 85(1) unless certain conditions set out therein are met. One of these conditions is that the transfer of the property to the corporation was not part of a series of transactions in which control of the corporation was acquired. Subsection 256(7) is amended, for dispositions occurring after 1984, by adding a reference to new subsection 85(1.2).

Subclause 198(4)

ITA
256(7)(a)

Paragraph 256(7)(a) of the Act identifies particular circumstances in which control of a corporation will not be considered to have been acquired for the purposes of certain provisions of the Act. Paragraph 256(7)(a) is amended, effective for redemptions, acquisitions and cancellations of shares occurring after 1989 (unless, in respect of redemptions and cancellations before July 14, 1990, the taxpayer makes an election), to ensure that the exception provided therein applies not only to a particular corporation upon the acquisition of its shares, but also to any corporations that may be controlled by the particular corporation. In addition, this amendment clarifies that the exception under paragraph 256(7)(a) may apply in respect of the redemption, acquisition or cancellation of shares of the particular corporation. A consequential amendment, including redemption and cancellations, has been made to subparagraph 256(7)(a)(i).

Clause 199

Securities Lending

ITA
260

Section 260 of the Act sets out the rules relating to securities lending arrangements.

Subclause 199(1)

ITA
260(1)

Subsection 260(1) of the Act sets out the definition of "securities lending arrangement". Paragraph (c) of this definition provides that in order for there to be a securities lending arrangement, the borrower of a security must be obligated to compensate the lender of the security for any dividends paid on the security during the term of the arrangement. The amendment to this paragraph provides that this obligation is required only where the security in question is a share of the capital stock of a corporation and applies only where the right to receive the dividend arises during the term of the arrangement.

Subclause 199(2)

ITA
260(8)

Subsection 260(8) of the Act provides that certain payments received by a non-resident lender under a securities lending arrangement are subject to the non-resident tax and withholding requirements under Part XIII of the Act. The wording used in subsection 260(8) is amended to conform with that used elsewhere in Part XIII and other parts of the Act.

Paragraph 260(8)(a) provides that where a borrower of a security, under a securities lending arrangement, has throughout the term of the arrangement furnished to the lender money or government debt obligations having at least 95% of the value of the borrowed security and the borrower is entitled to enjoy the benefits of substantially all the income from and opportunity for gain with request to the money or debt obligations, any payments made by the borrower as compensation for any dividends or interest paid in respect of the security will, to the extent of the dividends or interest, be treated for the purposes of Part XIII as a payment of a dividend or interest, as the case may be, on the security by the borrower to the lender. Conversely, amended subsection 260(8) provides that in any other circumstances an amount paid by the borrower to the lender that is treated as a payment of interest is, for the purposes of Part XIII and any income tax convention to which Canada is a party, not to be considered as being interest paid on or in respect of the borrowed security. The amendments clarify that, where the borrowed security is a long-term corporate debt obligation, the lender will continue to be entitled to the benefit of the exemption from non-resident withholding tax provided under subparagraph 212(1)(b)(vii) of the Act in respect of any compensation payments made on the security.

Paragraph 260(8)(b) provides that any payment made to a non-resident for the use of a security will be considered to be a payment of interest and therefore will be subject to non-resident withholding tax. Paragraph 260(8)(b) is amended to provide instead that amounts paid on account of, in lieu of payment of, or in satisfaction of, a fee will be subject to Part XIII tax as interest. The amendment also provides that where a non-resident lender has received money as collateral or consideration for a loaned security and the resident borrower has not paid a reasonable fee for the use of the security, the difference between interest on the money held by the lender, calculated at a prescribed rate, and any amount which is paid to the borrower by the lender other than as a return of the collateral or consideration will be considered to be a fee paid for the use of the security.

These amendments are generally applicable with respect to transfers, loans and payments made after April 26, 1989.

Clause 200

Reorganizations and Conversions

ITAR
26(28)

Subsections 26(21) to (27) of the Income Tax Application Rules, 1971 provide for the preservation of a taxpayer's "tax-free zone" and pre-1972 capital surplus on hand ("CSOH") relating to shares, options and certain debt instruments owned by the taxpayer on December 31, 1971. For example, in the case of an amalgamation to which section 87 of the Income Tax Act applies, subsection 26(21) allows a shareholder of a predecessor corporation who owned shares of that corporation on December 31, 1971 to preserve his tax-free zone and pre-1972 CSOH in respect of those shares notwithstanding the disposition of such shares in consideration for shares of the new corporation formed on the amalgamation.

Currently, however, these Rules apply only in respect of the first reorganization to which section 85.1, 86 or 87 of the Act applies and to the first conversion to which section 51 or 77 of the Act applies. New subsection 26(28) of the Rules, which applies to acquisitions of property occurring after July 13, 1990 except where the taxpayer elects in specific circumstances to have it apply to acquisitions after May 6, 1974, provides for the preservation of the tax-free zone and pre-1972 CSOH on successive applications of any of subsections 26(21) to (27).

Clause 201

Pre-1972 Resource Expenditures

ITAR
29

Section 29 of the Income Tax Application Rules, 1971, provides for carrying forward and deducting unused drilling, exploration and development expenses incurred prior to 1972 and deducting them in the 1972 and subsequent taxation years. It also provides, in subsection (25) thereof, for successor deductions for resource corporations for pre-1972 resource expenditures incurred by another taxpayer. The deductions are generally limited to specified amounts of related resource income.

Section 29 of the Rules is amended so that amounts included in computing a taxpayer's income under paragraphs 59(3.2)(b) and (c) of the Act increase the limits for deductions by the taxpayer under subsections 29(11) and (12) of the Rules. This amendment is strictly consequential to the repeal of clause 66(3)(b)(ii)(C) of the Act. It is applicable to the 1985 and subsequent taxation years.

Section 29 of the Rules is also amended to eliminate references to subsection (29) thereof and to subsections 66(6) and (7) and 66.1(4) and (5) of the Act, strictly as a consequence of the repeal of those subsections. This amendment is applicable to taxation years ending after February 17, 1987.

Subsection 29(25) is further amended to ensure that a successor may claim no more as a deduction in this respect than the unused portion of such expenditures. This amendment is also applicable to taxation years ending after February 17, 1987.

Clause 202

Foreign Property

ITAR
65(5)

Part XI of the Income Tax Act provides for a penalty tax for certain tax-exempt persons on holdings in excess of specified limits of foreign property that was acquired after June 18, 1971. Subsection 65(5) of the Income Tax Application Rules, 1971 is a special transitional rule applying where a specified tax-exempt person has held shares in a mutual fund corporation continuously from June 18, 1971 that are foreign property under Part XI of the Income Tax Act. If the mutual fund corporation amalgamates with another mutual fund corporation and the tax-exempt shareholder receives only shares of the new corporation, the shares of the new corporation are treated as having been acquired prior to June 18, 1971 by virtue of this rule. In such circumstances, there would be no penalty tax on the shareholder under Part XI with respect to the cost amount of the shares of the new corporation.

Subsection 65(5) of the Rules is amended, strictly as a consequence of a restructuring of Part XI, to change a reference from "subsection 206(1)" to "subsection 206(2)" and a reference from "subsection 206(2)" to "subsection 206(1)".

This amendment is applicable with respect to periods occurring after October 31, 1985.

Clause 203

Canada Pension Plan - Definitions

CPP
2

"prescribed"

Section 2 of the Canada Pension Plan sets out a number of definitions used in the Act. The definition of "prescribed" is amended to refer to a form authorized rather than a form prescribed by the Minister of National Revenue. This parallels a similar change to the same definition in the Income Tax Act.

"balance due day"

Section 2 of the Canada Pension Plan is also amended to introduce the definition "balance due day". The definition is relevant for the purposes of the proposed amendments to paragraph 30(a), section 33 and subsection 34(1) of the Canada Pension Plan, relating to the payment of CPP contributions by self-employed individuals and arrears interest for the late payment of such contributions. These amendments parallel similar proposed changes to the Income Tax Act and are intended to provide consistent rules for the payment of income tax and CPP contributions by self-employed individuals.

The "balance due day" of an individual for a year for CPP purposes is April 30 of the following year. However, where the individual died after October 31 in the year and before May 1 in the immediately following year, the "balance due day" of the individual is 6 months after the day of death.

This amendment is applicable after 1989.

Clause 204

Communal Organizations

CPP
14.1

The amount of self-employed earnings of an individual for the purposes of the Canada Pension Plan is determined under section 14 of the Canada Pension Plan. This amount is relevant for the purposes of determining required contributions and benefits with respect to the Canada Pension Plan.

New section 14.1 of the Canada Pension Plan is introduced so that amounts in respect of a business carried on by a congregation allocated to a family in the congregation under the special rules in subsection 143(2) of the Income Tax Act for a taxation year are treated as income of the member of the family specified in the election under that provision from such a business carried on by the member. This amendment, which applies to the 1982 and subsequent years, is necessary because, pursuant to paragraph 108(5)(a) of the Income Tax Act, such amounts are generally treated as income from property rather than business income.

Clause 205

Failure to Remit
Source Deductions

CPP
21(7)(b)

Subsection 21(7) of the Canada Pension Plan provides that an employer is liable to a penalty in respect of amounts which it has failed to remit to the Receiver General as and when required. Paragraph 21(7)(b) is amended, applicable upon Royal Assent, to parallel paragraph 227(9)(b) of the Income Tax Act with respect to the penalty payable for repeated failures.

Clause 206

Application of Income Tax Act Provisions

CPP
23(2)

Subsection 23(2) of the Canada Pension Plan makes a number of provisions of the Income Tax Act applicable, with such modifications as the circumstances require, to amounts payable under the Canada Pension Plan.

Subsection 224(1.2) of the Income Tax Act contains a garnishment provision which is one of the principal means used by Revenue Canada, Taxation to collect unremitted source deductions. This subsection permits Revenue Canada to intercept payments that are owed to a tax debtor and that are being made either to the tax debtor directly or to a secured creditor of the tax debtor under a security agreement, such as an assignment of trade receivables, in favour of that creditor. One of the amendments to subsection 23(2) of the Canada Pension Plan clarifies that the garnishment provision in subsection 224(1.2) of the Income Tax Act applies with respect to the employer's as well as the employee's portion of Canada Pension Plan contributions. This amendment is applicable to the 1985 and subsequent calendar years.

A second amendment to subsection 23(2) of the Canada Pension Plan, applicable after July 13, 1990, adds a reference to section 160 of the Income Tax Act to adopt the rules relating to joint and several liability for certain unpaid amounts where property has been transferred to a minor, a spouse or a non-arm's length person.

In addition, subsection 23(2) is amended by the addition of a reference to new subsection 220(3.1) of the Income Tax Act, which provides for the waiving or cancellation of penalties and interest. For additional information, reference may be made to the commentary on that new subsection. This amendment is applicable to penalties and interest in respect of 1985 and subsequent years.

Finally, a reference to new section 221.1 of the Income Tax Act has been added to subsection 23(2). This clarifies that the provisions of the Canada Pension Plan relating to the calculation of interest apply with respect to amendments to that Act from the year in which such amendments become applicable. This amendment applies with respect to amendments to, and enactments related to, the Canada Pension Plan that are assented to or promulgated after 1989.

Clause 207

Books and Records

CPP
24(3)

Section 24 of the Canada Pension Plan requires employers to keep records and books of account for a six year period or until written permission is provided by the Minister of National Revenue for their prior disposal. New subsection 24(3), which applies on Royal Assent, provides that employers affected by the determination of a question by, or by an appeal to, the Minister under section 27 are to retain records and books of account until the appeal procedure is terminated. This amendment is intended to ensure that records and books of account are retained in situations where an appeal extends beyond the six year period, as may be the case where an appellant is given leave to appeal to the Supreme Court of Canada.

Clause 208

Inspections and Warrants: Documents

CPP
25

Section 25 of the Canada Pension Plan provides rules under which an authorized person may inspect, audit or examine documents that relate to information that should be contained in records and books of account. The definition "documents" in subsection 25(1) is amended, applicable upon Royal Assent, in order to parallel the definition of that term in section 231 of the Income Tax Act.

Clause 209

Returns

CPP
30(1)(a)

Section 30 of the Canada Pension Plan requires a person to file a return for a year reporting the amount of the person's self-employed earnings for CPP purposes for the year. Where a person dies before filing a return, the legal representatives of the person are given 6 months from the date of death to file the return. The CPP return for a year is filed with a person's income tax return for the year.

Paragraph 30(1)(a) of the Canada Pension Plan is amended to clarify that the legal representatives of a deceased person are required to file the person's CPP return for the year of death no earlier than April 30 following the year of death. Where the taxpayer died after October 1 in such year and before May 1 in the following year, the legal representatives continue to have 6 months from the date of death to file the return for such year.

This amendment is consequential to a similar amendment to paragraph 150(1)(b) of the Income Tax Act and is applicable with respect to deaths occurring after October, 1990.

Clause 210

Instalments

CPP
33

Section 33 of the Canada Pension Plan generally requires instalments of CPP contributions in respect of self-employed earnings for a year to be paid on or before March 31, June 30, September 30 and December 31 of the year. The remainder of CPP contributions are required to be paid before April 30 in the following year. There are exceptions to this general rule for persons required to make less than $40 of CPP contributions for the year, for persons not required to remit income tax instalments for the year and for persons whose chief source of income is farming or fishing.

Section 33 of the Canada Pension Plan is amended so that the unpaid remainder of a deceased person's CPP contributions for a year is, in all cases, required to paid on or before the person's "balance due day" for the year. The "balance due day" for a year, as defined in amended section 2 of the Canada Pension Plan, is generally April 30 of the following year. Where a person has died after October 31 in a year and before May 1 in the following year, the person's balance due day for the year is six months following the date of death.

Section 33 of the Canada Pension Plan is also amended so that the legal representatives of an individual are not required to remit CPP instalments that would otherwise become payable after the death of the individual. This is consistent with Revenue Canada's existing administrative practice.

Section 33 of the Canada Pension Plan is further amended so that the CPP quarterly instalments payable by individuals whose chief source of income is not farming or fishing are payable on the 15th of March, June, September and December rather than at the end of those months.

These amendments are consequential to similar amendments to subsections 153(2), 155(1) and 156(1) and section 156.1 of the Income Tax Act. The amendments are applicable to 1990 and subsequent years.

Clause 211

Interest on Unpaid Contributions

CPP
34(1)

Subsection 34(1) of the Canada Pension Plan provides for interest to be payable by a person in respect of the amount of CPP contributions for a year that are unpaid after April 30 of the following year.

Subsection 34(1) of the Canada Pension Plan is amended so that the period in respect of which interest is payable by a person in respect of unpaid contributions for a year commences on the "balance due day" of the person for the year. In the case of a person who died after October 31 in a year and before May 1 in the following year, the "balance due day" for this purpose (as defined in amended section 2 of the Canada Pension Plan) is six months after the day of death. In any other case, the "balance due day" of a person for a year continues to be April 30 of the following year.

This amendment is applicable to 1990 and subsequent years.

Clause 212

Penalties

CPP
35

Subsection 35(1) of the Canada Pension Plan imposes a 5% penalty where a person fails to file a return of his self-employed earnings. This amendment, which applies after September 12, 1988, allows the Minister of National Revenue to waive the 5% penalty where the person is also liable to a penalty under subsection 162(2) of the Income Tax Act relating to repeated penalties.

Clause 213

Application of Income Tax Act Provisions

CPP
36

Section 36 of the Canada Pension Plan makes a number of provisions of the Income Tax Act applicable, with such modifications as the circumstances require, to amounts paid or payable as or on account of contributions in respect of earnings from self-employment.

Section 36 is amended, applicable upon Royal Assent, by adding a reference to the provisions of Divisions I and J of Part I of the Income Tax Act which are related to interest (that is, paragraph 160.1(1)(b) and subsections 161 (2.2) and 164(3.1) of the Income Tax Act) and excess refunds (that is, paragraph 160.1(1)(a) of the Income Tax Act).

Clause 214

Refunds

CPP
38(5) and (6)

Subsection 38(5) of the Canada Pension Plan allows the Minister of National Revenue to recover refunds in respect of contributors by an employee in excess of the amount that should have been refunded. The amendment extends the same right of recovery where, instead of being refunded to the employees, the excess was applied to reduce any other liability of the employee to her Majesty in right of Canada.

Subsection 38(6) if the Canada Pension Plan is amended to permit the Minister of National Revenue to apply any refund payable to a person as an offset against indebtedness that the person is liable for, or about to become for, to Her Majesty in right of Canada. This amendment parallels a similar amendment to subsection 164(2) of the Income Tax Act.

The amendments to section 38 are applicable on Royal Assent.

Clause 215

Regulations

CPP
40(3)

Subsection 40(3) of the Canada Pension Plan provides that a regulation prescribing an amount referred to in subsection 21(1) of that Act has effect only when published in the Canada Gazette unless the regulation itself provides that it is to be effective for an earlier period. Subsection 21(1), which concerns employers obligations to withhold and remit employees' C.P.P. contributions, no longer provides for such withholding and remission of a prescribed amount, but rather such amount as is determined in accordance with prescribed rules. Subsection 40(3) is amended, applicable after Royal Assent, to accord with this wording and also to permit such a regulation to have effect from a date that is after its publication in the Canada Gazette.

Clauses 216 to 219

Cultural Property Export and Import Act

CPEIA
20(c)

Paragraph 20(c) of the Cultural Property Export and Import Act empowers the Canadian Cultural Property Export Review Board to make certain determinations for the purposes of the rules in the Income Tax Act governing the tax treatment of gifts of certified cultural property to designated Canadian institutions. Paragraph 20(c) is amended as a consequence of the introduction of the charitable donation tax credit and new subsection 118.1(10) of the Income Tax Act to permit such determinations to be made for the purposes of those provisions. This amendment is generally applicable after December 11, 1988.

CPEIA
22

Section 22 of the Cultural Property Export and Import Act is amended, applicable after February 20, 1990, as a consequence of amendments to that Act and to the Income Tax Act which empower the Canadian Cultural Property Export Review Board to determine the fair market value of certain objects for tax purposes. Subsection 22(1) is amended to delete the requirement that the persons from whom advice is obtained by the Board be employed in the Public Service. Subsection 22(2) is amended to allow the Minister of Communications to retain experts to assist the Board in determining the value of objects disposed of to institutions or public authorities.

CPEIA
32(1) and (2)

Subsections 32(1) and (2) of the Cultural Property Export and Import Act are amended to correct section references as a consequence of the introduction of the charitable donation tax credit in the Income Tax Act and to provide for the determination by the Canadian Cultural Property Export Review Board of the fair market value of objects donated or proposed to be donated to certain institutions.

The reference changes included in this amendment apply after December 11, 1988. The amendments concerning the determination of fair market value apply only to gifts made after February 20, 1990.

CPEIA
32(5)

New subsection 32(5) of the Cultural Property Export and Import Act provides the Canadian Cultural Property Export Review Board with the power to redetermine an original determination of the fair market value of an object under subsection 32(1) of that Act where additional information affecting the accuracy of that determination is received by the Board. This new subsection applies to gifts of objects made after February 20, 1990.

CPEIA
33(1) and (2)

Section 33 of the Cultural Property Export and Import Act is replaced by new subsections 33(1) and (2). Subsection 33(1) provides that the Canadian Cultural Property Export Review Board is to issue a certificate for income tax purposes at the time it determines the fair market value of an object and that the object meets the criteria set out in paragraphs 29(3)(b) and (c) of the Act, and also at any time when the Board redetermines the fair market value of an object. Subsection 33(2) provides that members of the Board or officials of the Department of Communications may communicate information to officials of Revenue Canada, Taxation for the purpose of administering the Income Tax Act.

New subsection 33(1) applies to gifts made after February 20, 1990. New subsection 33(2) is applicable after Royal Assent.

Clause 220

Income Tax Conventions
Interpretation Act

Section
6.2

The Income Tax Conventions Interpretation Act contains rules that govern the interpretation of certain provisions of the tax treaties concluded by Canada. This amendment adds new section 6.2 to the Act.

This new section is consequential on the decision of the English Court of Appeal in the case of The Queen v. Padmore. In that decision, it was held that a resident partner's share of the income of a partnership managed in another country may be considered to be the income of a resident of that other country for purposes of a tax treaty.

New section 6.2 is intended to preclude the application in Canada of the reasoning developed in the Padmore case. It clarifies that the tax treatment of a Canadian resident partner's share of the income of the partnership is not affected by the fact that the partnership may be considered to be a resident or enterprise of another country under a tax treaty concluded by Canada.

Since this amendment simply recognizes the generally accepted interpretation, it is made applicable after June 23, 1983, the date on which the Income Tax Conventions Interpretation Act came into force.

Clauses 221 to 223

Tax Court of Canada Act

12(4) and 18.29(3)

These amendments to subsections 12(4) and 18.29(3) of the Tax Court of Canada Act are strictly consequential on the introduction of new sections 166.1, 166.2 and 167 of the Income Tax Act which concern applications for extension of time to file notices of objections and appeals. These amendments are to come into force on the day that is 30 days after Royal Assent.

Clause 224

Unemployment Insurance Act - Definitions

UI
2(1)
"Prescribed"

Section 2 of the Unemployment Insurance Act sets out a number of definitions used in the Act. The definition of "prescribed" is amended, effective on Royal Assent, to refer to a form authorized rather than a form prescribed by the Minister of National Revenue. This parallels a change made to the same definition in subsection 248(1) of the Income Tax Act.

Clause 225

Definition of Document

UI
52

Section 52 of the Unemployment Insurance Act defines a number of terms which apply for the purposes of certain provisions concerning the collection of premiums under that Act. The definition "documents" is amended, applicable upon Royal Assent, to parallel the definition of that term in section 231 of the Income Tax Act.

Clause 226

Failure to Remit
Source Deductions

UI
53(7)(b)

Subsection 53(7) of the Unemployment Insurance Act provides that an employer is liable to a penalty in respect of amounts which it has failed to remit to the Receiver General as and when required. Paragraph 53(7)(b) is amended, applicable upon Royal Assent, to increase the ordinary penalty of 10% to 20% for repeated failures to remit U.I. source deductions in a year. This amendment conforms this penalty to that provided in 227(a) of the Income Tax Act relating to the failure to remit income tax deducted at source from payments to employees..

Clause 227

Retention of Books and Records

UI
58(4)

Section 58 of the Unemployment Insurance Act requires employers to keep records and books of account for a six year period or until written permission is provided by the Minister of National Revenue for their prior disposal. New subsection 58(4), which applies on Royal Assent, provides that employers affected by the determination of a question by, or by an appeal to, the Minister under section 61 of the Act are to retain records and books of account until the appeal procedure is terminated. This amendment is intended to ensure that records and books of account are retained in situations where an appeal extends beyond the six year period, as may be the case where an appellant is given leave to appeal to the Supreme Court of Canada.

Clause 228

Refunds

UI
63(4) and (5)

Subsection 63(4) of the Unemployment Insurance Act allows the Minister of National Revenue to recover refunds in respect of premiums paid by an employee in excess of the amount that should have been refunded. This amendment extends the same right of recovery where, instead of being refunded, the excess was applied to reduce any other liability of the employee to Her Majesty in right of Canada.

Subsection 63(5) of the Act is amended to permit the Minister of National Revenue to apply any refund payable to a person as an offset against any indebtedness that the person is liable for, or about to become liable for, to Her Majesty in right of Canada. This amendment parallels a similar amendment to subsection 164(3) of the Income Tax Act.

The amendments to section 63 are applicable on Royal Assent.

Clause 229

Application of Income Tax Act Provisions

UI
66

Section 66 of the Unemployment Insurance Act makes a number of provisions of the Income Tax Act applicable, with such modifications as the circumstances require, to amounts payable under Part III of the Unemployment Insurance Act.

Subsection 224(1.2) of the Income Tax Act contains a garnishment provision which is one of the principal means used by Revenue Canada, Taxation to collect unremitted source deductions. This subsection permits Revenue Canada to intercept payments that are owed to a tax debtor and that are being made either to the tax debtor directly or to a secured creditor of the tax debtor under a security agreement, such as an assignment of trade receivables, in favour of that creditor. One of the amendments to section 66 of the Unemployment Insurance Act clarifies that the garnishment provision in subsection 224(1.2) of the Income Tax Act applies with respect to the employer's as well as the employee's portion of unemployment insurance premiums. This amendment is applicable after July 13, 1990.

Another amendment to section 66 of the Unemployment Insurance Act, also applicable after July 13, 1990, adds a reference to section 160 of the Income Tax Act to adopt the rules relating to joint and several liability for certain unpaid amounts where property has been transferred to a minor, a spouse or a non-arm's length person.

In addition, a reference to new section 221.1 of the Income Tax Act has been added to section 66. This clarifies that the provisions of Part III of the Unemployment Insurance Act relating to interest apply with respect to any amendments to the Part from the year in which such amendments are applicable. This amendment applies with respect to amendments to, and enactments related to, Part III of the Unemployment Insurance Act that are assented to or promulgated after 1989.

In addition, section 66 is amended by the addition of a reference to new subsection 220(3.1) of the Income Tax Act, which provides for the waiving or cancellation of penalties and interest. For additional information, reference may be made to the commentary on that new subsection. This amendment is applicable to penalties and interest in respect of 1985 and subsequent years.

Clause 230

Forms Prescribed or Authorized

UI
69(15)

This amendment simply provides that any form purporting to be prescribed or authorized by the Minister of National Revenue shall be deemed to be a form authorized by the Minister unless called into question by the Minister or someone acting on his behalf. This parallels a similar charge to the definition of "prescribed" in the Income Tax Act and the Canada Pension Plan.

Members of Partnerships

UI
69(19)

New subsection 69(19) of the Act provides that any notice or document provided to a partnership (or in the case of a limited partnership to a partner whose liability is not limited) shall be deemed to have been provided to each member of the partnership. This rule is identical to the rule provided in new subsection 244(20) of the Income Tax Act, and is effective on Royal Assent.

Clause 231

Definition - "Documents"

UI
94(21)

Subsection 94(21) of the Unemployment Insurance Act defines a number of terms which apply for the purposes of section 94. The definition "documents" is amended, applicable upon Royal Assent, in order to parallel the definition of that term in section 231 of the Income Tax Act.

Clause 232

Definition - "income"

UI
122

This amendment alters the definition of "income" in section 122 of the Unemployment Insurance Act as a consequence of the introduction of new paragraph 60(v.1) (which provides for the deduction in computing income of any unemployment benefit repayment made pursuant to Part VII of the Unemployment Insurance Act) and paragraph 60(w) (which provides for the deduction in computing income of any repayment of federal family allowances or old age security benefits required under new Part I.2 of the Income Tax Act) of the Income Tax Act. As a result of this amendment, "income" for the purposes of Part VII of the Unemployment Insurance Act will mean income before deducting any repayment of unemployment insurance benefits as required under that Part and before deducting any repayment of old age security benefits or federal family allowances. This amendment is effective after 1988.

Clauses 233 and 234

Deceased Persons

UI
123 and 124(a)

Section 123 of the Unemployment Insurance Act requires a claimant to repay a specified portion of an unemployment insurance benefit for a taxation year where the income of the claimant under the Income Tax Act exceeds a specified threshold. The amount is required to be repaid on or before April 30 in the following year.

Section 124 of the Unemployment Insurance Act requires a claimant to file a return with respect to a benefit repayment under section 123 of that Act for a taxation year as part of the claimant's income tax return for the year. This return is also generally required to be filed on or before April 30 in the following year.

Paragraphs 124(a) and (b) of the Unemployment Insurance Act are amended so that the legal representatives of a person who died after October 31 in a year and before May 1 in the following year are not required to file a return under section 124 of that Act for the year until six months of the day of death. Section 123 of that Act is likewise amended so that a benefit repayment for a year becomes payable at the same time as the return is normally required to be filed under amended paragraph 124(a) or (b) of that Act. These amendments are consequential to an amendment to paragraph 150(1)(b) of the Income Tax Act and are applicable with respect to deaths occurring after October, 1990.

Clause 235

Application of <u>Income Tax Act</u>

UI
126

Section 126 of the <u>Unemployment Insurance Act</u> adopts, for the purposes of Part VII of the Act, a number of provisions of the <u>Income Tax Act</u> relating to assessments, interest, penalties and appeals. This amendment, which applies after Royal Assent, adds a reference to section 160.1 of the <u>Income Tax Act</u> to provide that amounts paid or credited to a person in excess of the amount to which he was entitled are to be treated as a liability of that person payable, with interest, from the time at which the excess amount was so paid or credited.

In addition, a reference to new section 221.1 of the <u>Income Tax Act</u> has been added to section 126. This clarifies that the calculation of interest under Part VII that results from amendments to the Part will be calculated from the year in which such amendments become applicable. The addition of this reference applies with respect to amendments to, and enactments relating to, Part VII of the <u>Unemployment Insurance Act</u> that are assented to or promulgated after 1989.

Clause 236

Partnership Ceasing to Exist

Subs. 26(5)
S.C. 1986, c.55

ITA
98(5)

Subsection 98(5) of the Income Tax Act is a non-elective provision which applies only in situations where a Canadian partnership has ceased to exist and one member continues to carry on the business of the partnership as a sole proprietorship.

This subsection provides that the partnership shall be deemed to have disposed of its property at its cost amount and that the remaining member is deemed to have acquired the property at the same amount. Where the adjusted cost base of the member's partnership interest, including the interests acquired from other members of the partnership, exceeds the amount of any money and the cost amount to the partnership of the property received by him upon the dissolution, the member may designate this excess to be added to the cost base of one or more particular properties. Paragraph 98(5)(d) of the Act, which allowed one-half of this excess to be allocated to property (up to the fair market value of that property) other than non-depreciable capital property, was repealed, applicable with respect to certain events occurring after December 4, 1985. However, this paragraph continues to apply to certain "grandfathered" partnership property and, as a result, is amended to change the reference in subparagraph 98(5)(d)(iii) from "1/2" to the fraction that represents the partner's capital gains inclusion rate for the year in which the partnership ceased to exist.

Clauses 237 and 238

Canada-Newfoundland Atlantic Accord Implementation Act, S.C. 1987, c.3
Subsection 239(2)

Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act, S.C. 1988, c.28
Subsection 267(2)

Subsections 239(2) of the Newfoundland accord act and 267(2) of the Nova Scotia accord act provide that the taxation measures with respect the Newfoundland and Nova Scotia accords apply with respect to taxation years commencing after a date to be fixed by proclamation. The date fixed by proclamation with respect to most measures in the Newfoundland accord act was April 4, 1987 and with respect to most measures in the Nova Scotia accord act was December 22, 1989.

The two subsections are amended to ensure that these taxation measures apply with respect to taxation years commencing after April 4, 1987 and December 22, 1989, respectively.

The amendments apply as of the dates that the accord acts came into force.

Clause 239

Non-Arm's Length Acquisition of Depreciable Property

Subs. 6(23)
S.C. 1988, c.55

ITA
13(7)

Paragraph 13(7)(b) of the Income Tax Act determines the capital cost of depreciable property acquired by a taxpayer for a purpose other than to produce income where the taxpayer subsequently commences to use the property for the purpose of producing income. Paragraph 13(7)(d) applies to determine the capital cost of property where the use of the property for the purposes of gaining or producing income changes relative to other uses made of the property. Clauses 13(7)(b)(ii)(B) and (d)(i)(B) were amended in 1988, applicable to property acquired after May 22, 1985, to reflect the changes to the inclusion rates for capital gains. The provision enacting those amendments is amended to clarify that they are applicable to changes in use occurring after May 22, 1985.

Paragraph 13(7)(e) of the Act sets out special rules that apply in determining a taxpayer's capital cost of depreciable property acquired from a person or partnership with which he was not dealing at arm's length. The taxpayer's capital cost for this purpose is intended to be the cost or capital cost to the transferor at the time of the transfer plus the portion of any capital gain realized on the transfer on which the transferor was taxed. This paragraph was amended in Bill C-139 (1988) to reflect the changes to the inclusion rates for capital gains. This amendment to the provision enacting the amendments under Bill C-139 ensures that the capital gains inclusion rate of the transferor rather, than that of the taxpayer, is used in calculating the capital cost of the property to the taxpayer.

Clause 240

Cumulative Eligible Capital

Subs. 7(6)
S.C. 1988, c.55

ITA
14(5)(a)

Paragraph 14(5)(a) of the Income Tax Act, as amended by S.C. 1988, c.55, was subject to a transitional rule with respect to the computation of amounts to be included in a taxpayer's cumulative eligible capital. This transitional rule, applicable to dispositions of eligible capital property on or before June 17, 1987, required a taxpayer to deduct, in computing the taxpayer's cumulative eligible capital, amounts payable in respect of the disposition. This transitional rule is amended to ensure that amounts payable in respect of the disposition which were deducted in computing the taxpayer's cumulative eligible capital before the taxpayer's adjustment date are not also required to be deducted a second time in a later calculation of the taxpayer's cumulative eligible capital.

Clauses 241 and 242

Farming Businesses

Subs. 14(3) and 16(2)
S.C. 1988, c. 55

ITA
28 and 31(1)

This amendment to the enacting provisions for the tax reform amendments to sections 28 and 31 of the Income Tax Act relating to income and losses from the business of farming clarifies that the amendments to those sections are applicable to fiscal periods commencing after 1988, and not to all taxation years commencing after 1988. This change avoids the premature introduction of the new rules introduced in tax reform in respect of businesses whose fiscal periods do not coincide with the calendar year.

Clause 243

Tuition Fees

Paragraph 92(2)(c)
S.C. 1988, c.55

ITA
118.5

Subclause 92(2) of Bill C-139 (1988) provided the effective date for new credits for income tax purposes introduced in sections 118 to 118.94 of the Act.
Paragraph (c) of that subclause provided transitional rules for tuition fees paid or deducted in 1987 that related to courses taken in 1988. The amendment to this enacting provision ensures that no deduction is allowed twice (in 1987 and 1988) in respect of the same fees.

Clause 244

Credit Union's 1971 Reserve Adjustment

Subs. 123(4)
S.C. 1988, c. 55

ITA
137(1)

Subsection 137(1) of the Income Tax Act, which provided a special doubtful debt reserve for credit unions in lieu of the doubtful debt reserve provided to most other taxpayers under paragraph 20(1)(l) of that Act, was, subject to a transitional rule, repealed applicable to taxation years of credit unions commencing after June 17, 1987 and ending after 1987. This transitional rule applies to the first taxation year of a credit union that commences after June 17, 1987 and ends after 1987 to require the prior year's reserve deducted under paragraph 137(1)(a) or (b) to be included in the credit union's income under paragraph 137(1)(c) to the extent that the reserve exceeds the prescribed amount of its 1971 reserve adjustment, as determined under section 8102 of the Income Tax Regulations. This transitional rule is amended to provide that the prescribed amount of a credit union's 1971 reserve adjustment may be deducted under paragraph 137(1)(d) in computing the credit union's income for that year rather than being offset against the inclusion for the year in respect of any reserves claimed for the preceding year under paragraphs 137(1)(a) and (b). This amendment ensures that a credit union that deducted a doubtful debt reserve under paragraph 20(1)(l) of the Act in the year prior to its first taxation year that commences after June 17, 1987 and ends after 1987, in lieu of a deduction under paragraph 137(1)(a) or (b) of the Act, is able to deduct the prescribed amount of its 1971 reserve adjustment.

Clause 245

Penalties

Section 141
S.C. 1988, c.55

ITA
162

Section 162 of the Act was amended by Chapter 55 of the Statutes of Canada, 1988 to introduce a number of new penalties for the failure to comply with provisions of the Act or the Income Tax Regulations, including a penalty for the failure to file a partnership information return and a $10 penalty for the issuance of a cheque in payment of an amount payable under the Act where the cheque is dishonoured when duly presented for payment. This $10 penalty was to be effective on a day to be fixed by order of the Governor in Council, but no such day has ever been fixed.

The amendments to section 162 provide that where there has been a failure to file a partnership information return, the partnership will be liable to a penalty under new subsection 162(7.1) instead of the members of the partnership being liable for penalties under subsection 162(7). In the case of repeated failures to file partnership information returns, the partnership will be liable to the additional penalty under subsection 162(8). New subsection 162(8.1) allows the penalties under subsection 162(7) and (8) to be assessed against the partnership and applies the provisions of the Act relating to assessments, payments and appeals with respect to those penalties as if the partnership were a corporation. New subsections 162(7.1) and (8.1) and the amendment to subsection 162(8) are applicable on Royal Assent.

Section 162 is also amended by repealing the penalty under subsection 162(11) with respect to dishonoured cheques, effective as of September 13, 1988.

Clause 246

"term preferred share"

Subs. 188(26)
S.C. 1988, c.55

ITA
248(1)

Subsection 248(1) of the Income Tax Act sets out the definition "term preferred share", which was amended in Bill C-139 (1988) with application after June 18, 1987. This amendment to the provision enacting the Bill C-139 changes to paragraph (a) of the definition is intended to preserve the transitional relief provided under subsection 128(23), S.C. 1980-81-82-83, C.140, with respect to certain shares issued after November 16, 1978 and before November 13, 1981.

Clause 247

Guaranteed Shares

Subs. 193(5)
S.C. 1988, c.55

ITA
258(3)

Subsection 258(3) of the Act provides that certain dividends received by a corporation from a corporation not resident in Canada are to be treated, for the purposes of paragraphs 12(1)(c) and (k) and sections 113 and 126 of the Act, as having been received in the form of interest. Paragraph 258(3)(b) was amended in 1988 to limit its application to dividends to which subsection 112(2.2) of the Act, as it read on June 18, 1987, would have applied if the corporation paying the dividend were a taxable Canadian corporation.

This amendment to subsection 193(5) of S.C. 1988, c.55 clarifies that paragraph 258(3)(b) of the Act does not also apply to dividends on shares (other than grandfathered shares) issued or deemed by paragraph 112(2.2)(f) to have been issued after 8 p.m. E.D.S.T., June 18, 1987. Dividends received on such shares are subject to subsection 258(5) of the Act.

Clauses 248 and 249

Tax Court of Canada Act

Subs. 18(2) and section 23
S.C. 1988, c.61

The Tax Court of Canada Act was amended in 1988 by S.C. 1988, c.61. The amending Act contained a number of consequential income tax amendments which were to come into force on a day to be fixed by order of the Governor in Council. The day that has been fixed for that purposes is January 1, 1991.

Clause 248

Subsection 18(2) of S.C. 1988, c.61 would amend subsection 172(3) of the Income Tax Act to delete the words "notwithstanding section 24 of the Federal Court Act". However, that amendment has been superseded by changes made to subsection 172(3) by S.C. 1990, c.35 (Bill C-52), which received Royal Assent on June 27, 1990. Accordingly, subsection 18(2) of S.C. 1988, c.61 is no longer necessary and is repealed by clause 248, effective September 22, 1988, which was the date of Royal Assent to S.C. 1988, c.61.

Clause 249

Section 23 of S.C. 1988, c.61 would amend subsections 225.1(3) to (5) of the Income Tax Act to delete references to the Federal Court - Trial Division. Those amendments to subsections 225.1(3) and (4) have been superseded by S.C. 1990, c.34 (Bill C-51), which received Royal Assent on June 27, 1990. The amendments to subsections 225.1(3) and (4) that would be made by section 23 of S.C. 1988, c.61 are no longer necessary. As a result, that section is being repealed by clause 249 and the amendment that would have been made to subsection 225.1(5) by section 23 of S.C. 1988, c.61 is made in this Bill. This amendment is effective September 22, 1988, which was the date of Royal Assent to S.C. 1988, c.61.

Clauses 250 to 259

Clauses 250 to 259 amend S.C. 1990, c.39 which is the Act containing amendments to the Income Tax Act announced in the April 1989 budget.

Clause 250

Interest Accrual Rules - Debt Obligations

Subsection 4(6) of S.C. 1990. c.39 is a coming-into-force provision for amendments to section 12 of the Income Tax Act that relate to accrued interest income on certain debt obligations.

Section 4 of S.C. 1990. c.39 amended section 12 of the Income Tax Act to require accrued interest on investment contracts to be reported on an annual basis rather than at least every three years as was the case under the previous rules. This change was made applicable with respect to investment contracts "acquired or materially altered after 1989". Those quoted words are amended in this clause to read "last acquired after 1989". The addition of the word "last" clarifies that annual interest reporting will apply in respect of an investment contract that was last acquired after 1989, even if the contract had previously been acquired before 1990. The words "or materially altered" are deleted because it is intended that the only alterations after 1989 of an investment contract acquired before 1990 that should cause the annual investment income accrual rules to apply to the investment contract are those alterations that are material enough to be considered to be the acquisition of a new contract.

Clause 251

Interest Accrual Rules - Life Insurance Policies

The coming-into-force provision for section 5 of S.C. 1990, c.39 is amended to clarify that annual investment income accrual under section 12.2 of the Income Tax Act will apply in respect of a life insurance policy last acquired after 1989, even if the policy was previously acquired before 1990. The amendment also eliminates a reference to policies "materially altered" after 1989, because it is intended that the only alterations after 1989 of a policy acquired before 1990 that should cause the annual investment income accrual rules to apply to the policy are those alterations that are material enough to be considered to be the acquisition of a new policy.

Clause 252

Deductible Interest

Subsection 9(3) of S.C. 1990. c.39 is the coming-into-force provision for amendments to paragraph 20(1)(c) of the Income Tax Act that were consequential on changes to the interest accrual rules in sections 12 and 12.2 and the related provisions in paragraphs 56(1)(d) and (d.1) of the Act. The change to subsection 9(3) is strictly consequential on the changes made to the coming-into-force provisions for those two sections as described above.

Clause 253

Income Accrual - Annuity Payments

Subsection 11(6) of S.C. 1990, c.39 is the coming-into-force provision for amendments in that bill to paragraphs 56(1)(d) and (d.1) of the Income Tax Act that were consequential on changes to the interest accrual rules in sections 12 and 12.2 of that Act. The change to subsection 11(6) is strictly consequential on the changes made to the coming-into-force provisions for those two sections as described above.

Clause 254

Tax Credit - Large Corporations Tax

Section 125.3 of the Income Tax Act permits a corporation to deduct from its tax payable for a taxation year under Part I of the Act an amount determined by reference to its tax payable under Part I.3 (the tax on large corporations) and its "Canadian surtax payable" for the year under section 123.2 of the Act. Subsection 29(2) of S.C. 1990, c.39 provides that section 125.3 applies to taxation years ending after June 1989, and also sets out a special transitional rule, which provides that a corporation's "Canadian surtax payable" for taxation years commencing before July 1989 is to be determined on the basis of the proportion of the year that is after June 1989. The amendments to subsection 29(2) of S.C. 1990, c.39 correct a cross-referencing error and clarify the operation of the pro-rating adjustment applicable in determining a corporation's Canadian surtax payable for its taxation year straddling July 1, 1989.

Clause 255

Adjusted Cost Basis - Life Insurance Policies

Subsection 37(3) of S.C. 1990, c.39 is the coming-into-force provision for amendments to paragraph 148(9)(a) of the Income Tax Act that were consequential on changes to the interest accrual rules in sections 12 and 12.2 of the Act. The change to subsection 37(3) is strictly consequential on the changes to the coming-into-force provisions for those two sections as described above.

Clause 256

Reassessments

Section 38 of S.C. 1990, c.39 extends the reassessment period by one year for mutual fund trusts and corporations other than Canadian-controlled private corporations. Subsection 38(5) of that Act provides that the one-year extension is to be applicable after April 27, 1989, except for years that were already barred from reassessment as of April 28, 1989 because the original notice of assessment, or notification that no tax was payable, was mailed by Revenue Canada on or before April 27, 1986.

The proposed amendment to subsection 38(5) of S.C. 1990, c.39, and the addition of subsection 38(5.1) to that Act, confirm that reassessments made after April 27, 1989 and before October 23, 1990 (which was the date of Royal Assent to that Act) are as effective as they would have been if that Act had received Royal Assent on April 27, 1989.

New subsection 38(5.1) also confirms that where taxpayers filed waivers of the normal reassessment limits after April 27, 1989 and before October 23, 1990, the waivers are as effective as they would have been if the Act had received Royal Assent on April 27, 1989.

Clause 257

Large Corporations Tax

Section 48 of S.C. 1990, c.39 introduces Part I.3 of the Income Tax Act to implement the April 1989 budget proposal to apply a tax on a corporation's capital employed in Canada in excess of $10 million.

Subsection 48(3) of S.C. 1990, c.39 sets out the effective date for the implementation of Part I.3, and provides certain transitional rules relating to the pro-rating of tax under that Part for taxation years commencing before July 1989 as well as the calculation of a corporation's instalment base - and consequent instalment obligations - for taxation years ending before July 1993.

The amendments to subsection 48(3) of S.C. 1990, c.39 restrict the application of the transitional rule for calculating Part I.3 tax instalments to taxation years commencing before 1990; for subsequent taxation years, the rules set out in subsection 181.7(1) of the Income Tax Act will apply. The amendments also maintain the transitional rule establishing a corporation's Part I.3 instalment base in respect of taxation years commencing before July 1989.

Clause 258

Securities Lending Arrangements

Section 55 of S.C. 1990, c.39 introduces section 260 of the Income Tax Act, which sets out the rules relating to securities lending arrangements.

The coming-into-force provision in S.C. 1990, c.39 for subsections 260(6) and (7) of the Income Tax Act is amended to provide that 1/3 of any dividend compensation payments made after June, 1989 but before 1993 by a person resident or carrying on business in Canada through a permanent establishment and licensed under the laws of a province to trade in securities will be non-deductible by reason of subsection 260(6). The amendment also provides that 1/3 of such amounts will be deemed by subsection 260(7) of the Act to be dividend payments which result in a dividend refund under section 129 of the Act. Previously, this treatment was afforded only to dividend compensation payments made by licensed securities dealers who were also resident in Canada and only with respect to such payments made before April, 1990.

Clause 259

Coming-into-force for Amendments to S..C. 1990, c.39

This clause provides that the amendments in Clauses 250 to 258 to S.C. 1990, c.39--Bill C-28(1989)--shall be deemed to have come into force on October 23, 1990, which is the date on which that Act received Royal Assent.